Supreme Court, U.S.
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No. 04-252

In The

Supreme Court of the United States

MACY'S EAST, INC.,

Petitioner,

v.

COMMISSIONER OF REVENUE,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Judicial Court Of Massachusetts

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Massachusetts Supreme Judicial Court, by depriving Macy's East of valuable property rights of its estate in bankruptcy – its net operating losses – violated the Supremacy Clause.

2. Whether the Massachusetts Supreme Judicial Court's decision, which denied Macy's East's use of its net operating losses from four companies that were merged into it and whose business operations it continued, violates the principle set out by this Court in *Libson Shops, Inc. v. Koehler*, 353 U.S. 382 (1957), and conflicts with the decisions of other state courts, which apply such principle.

3. Whether the Massachusetts Supreme Judicial Court ignored this Court's decision in *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931), by failing to consider uncontested separate accounting calculations which established that extraterritorial values were being taxed by Massachusetts in contravention of the Commerce and Due Process Clauses.

LIST OF PARTIES

The parties are as stated in the caption.

RULE 29.6 STATEMENT

Federated Department Stores, Inc., a publicly traded company, owns more than 10 percent of the Macy's East, Inc. stock.

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PETITION FOR A WRIT OF CERTIORARI

This petition for a writ of certiorari respectfully seeks this Court's review of the May 27, 2004, judgment of the Massachusetts Supreme Judicial Court.

OPINIONS BELOW

The decision and order of the Supreme Judicial Court of the Commonwealth of Massachusetts (App. A at 1a-18a) is officially reported at 441 Mass. 797, 808 N.E.2d 1244. The appeal was transferred *sua sponte* from the Appeals Court to the Supreme Judicial Court by Order entered on January 22, 2004 (App. B at 19a). The prior decision of the Massachusetts Appellate Tax Board, dated April 30, 2002, is not officially reported, but is reprinted at Appendix C at 20a to this Petition. The Massachusetts Appellate Tax Board's findings of fact and report (App. D at 21a-46a) was issued on November 5, 2002, and is not officially reported.

JURISDICTION

The decision and order of the Supreme Judicial Court of the Commonwealth of Massachusetts was entered on May 27, 2004 (App. A at 1a). The jurisdiction of this Court rests upon 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Bankruptcy Clause of the United States Constitution, art. I, § 8, cl. 4, provides that Congress shall have the

power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."

The Supremacy Clause of the United States Constitution, art. VI, cl. 2, provides that "[t]his Constitution, and the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

The Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3, provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The Due Process Clause of the United States Constitution, amend. XIV, § 1, provides: "[N]or shall any State deprive any person of life, liberty, or property without due process of the laws."

Relevant portions of the Massachusetts statutes, regulations and pronouncements are set forth in Appendix E at 47a-56a, Appendix F at 57a-83a and Appendix G at 84a-87a, respectively.

STATEMENT

The Massachusetts Supreme Judicial Court, under the guise of administrative deference and under the cloak of the scope of review, allowed the State to arbitrarily, without statutory authority, disallow net operating losses ("NOLs") of corporations that merged into Macy's East pursuant to confirmed plans of bankruptcy reorganization. In reaching its decision, the Massachusetts Court violated

the Supremacy, Bankruptcy, Commerce and Due Process Clauses. The decision in Massachusetts is not an isolated aberration. It is another in a series of cases where States are arbitrarily disallowing NOLs. Only this Court can stop this disturbing trend.

Congress intended the Bankruptcy Code to be used to "revive the debtors' businesses and thereby preserve jobs and protect investors" and to "maximiz[e] the value of the bankruptcy estate." *Toibb v. Radloff*, 501 U.S. 157, 163 (1991). NOLs are often the most significant assets that a bankruptcy estate has. *Russell v. United States (In re Russell)*, 927 F.2d 413 (8th Cir. 1991); *Official Comm. of Unsecured Creditors v. PSS S.S. Co. (In re Prudential Lines, Inc.)*, 928 F.2d 565 (2d Cir. 1991), *aff'g* 119 B.R. 430 (Bankr. S.D.N.Y. 1990).

Commenting on the reorganization at issue here, one tax commentator, in discussing the critical role that the treatment afforded to NOLs has towards the success of a bankruptcy reorganization, recognized that: "If Macy's is unsuccessful in its reorganization attempt, the assets of the corporation will have to be liquidated. As a result, it is likely that 69,000 people will lose their jobs, and 20,000 suppliers will lose a major, if not primary, purchaser of their goods. It is easy to envision the domino effect that just this one failed reorganization could have on the national economy if Macy's is unable to restructure successfully." Michelle M. Arnopol, *Why Have Chapter 11 Bankruptcies Failed So Miserably? A Reappraisal of Congressional Attempts to Protect a Corporation's Net Operating Losses After Bankruptcy*, 68 Notre Dame L. Rev. 133, 135 (1992).

Against this backdrop is the decision of the Massachusetts Supreme Judicial Court, by which Macy's East, Inc. ("Macy's East") was deprived of its right to utilize the NOLs from four corporations (the "Predecessor Companies") that had merged into it and whose business operations were not only continued by Macy's East, but in fact generated all the income taxed by the Massachusetts Commissioner of Revenue ("Commissioner" or "Department").

The Massachusetts Supreme Judicial Court stripped Macy's East of its valuable property right while acknowledging that the Massachusetts' NOL provision "is silent on the matter [whether a surviving corporation can deduct pre-merger NOLs of corporations absorbed in a statutory merger]" (App. A at 9a), and that "the legislative history [regarding the issue] is inconclusive" (App. A at 10a),[1] relying only on the Commissioner's regulation, Code of Massachusetts Regulations, title 830, section 63.30.2(11) (App. F at 57a-83a), to support its position.[2] It placed no import on the intent implicit in the enactment of *all* provisions enabling NOLs to be used – to "ameliorate the unduly drastic consequences of taxing income strictly on an annual basis." *Libson Shops, Inc. v. Koehler*, 353 U.S.

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[1] Unlike the situation presented to this Court in *Butner v. United States*, 440 U.S. 48, 54 (1979), where this Court, faced with the question of whether federal or state law was determinative of whether a security interest in property extends to rents and profits derived from property, stated that "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law," there is no state law that would deprive Macy's East of its property right in its NOLs.

[2] That regulation provides, in pertinent part, that while the surviving corporation in a merger retains its NOLs, the NOLs of corporations absorbed in a merger are allegedly lost.

382, 386 (1957). Pyramided upon its failure to effectuate the legislative intent, it dismissed the import of the Supremacy Clause, concluding that "there is no deprivation of any property interest" (App. A at 17a).

Further, the Massachusetts Supreme Judicial Court found no Massachusetts legislative intent to depart from federal tax principles, yet it deprived Macy's East of its NOLs merely because the corporations that generated the NOLs and whose assets and liabilities were merged into Macy's East – a corporation formed to facilitate the Bankruptcy Court approved plan of reorganization – was a "new" entity. This Court has long rejected the entity rule, focusing instead on whether there was a "continuity of business enterprise" by the survivor to a merger seeking to use the NOLs of a merged corporation. *Libson Shops,* 353 U.S. at 386.

Finally, the Massachusetts Supreme Judicial Court rejected Macy's East's claims of Due Process and Commerce Clause violations on the basis that the uncontroverted "evidence it offered in support of its claims [establishing that actual taxation of extraterritorial values occurred] constituted calculations based on a separate accounting analysis, an accounting method that the commissioner was free to reject" (App. A at 17a). This Court has never restricted the manner of proof that can be used to establish that taxation of extraterritorial values occurred.

1. The Background and Operations of Macy's East

During the year in issue, Macy's East operated the same business in Massachusetts and elsewhere as had

been operated by its predecessors for over 100 years. Two separate retailers, Federated Department Stores, Inc. ("Federated") and R.H. Macy & Co. had come out of bankruptcy and rehabilitated themselves into several subsidiary corporations including Macy's East.

a. Jordan Marsh and Federated

Jordan Marsh Stores Corporation ("Jordan Marsh"), which began doing business in Massachusetts in 1841, operated full-line upscale retail department stores. In 1986, Campeau Corporation acquired Allied Stores Corporation ("Allied Stores") which by then owned Jordan Marsh.

In 1929 Federated was formed as a holding company by several family-owned department stores. By 1988, Federated's family of department stores included Abraham & Straus ("A&S").

On May 3, 1988, Federated was acquired by Campeau Corporation. The stores formerly owned by Allied Stores, including Jordan Marsh, became part of the Federated family of department stores.

Jordan Marsh continued to operate its department stores in New England, but began to incur large losses, as did other parts of Federated's business. On January 15, 1990, Federated and its subsidiaries, including Jordan Marsh, filed for protection under Chapter 11 of the Bankruptcy Code (App. A at 3a). As debtors in possession, they continued to operate their stores. Jordan Marsh continued to operate its stores in Boston and throughout New England.

On February 4, 1992, Federated emerged from bankruptcy pursuant to a plan of reorganization confirmed on January 10, 1992 (App. A at 3a). The Jordan Marsh business in New England continued to operate its stores unchanged, although back-office management activities were transferred to Brooklyn, New York. The names on the stores remained "Jordan Marsh." There was no change in operations or inventory carried.

b. Macy's

Meanwhile, another nationally recognized U.S. retailer, R.H. Macy & Co., Inc. ("Macy's"), was also experiencing problems.

Macy's operated its business through several subsidiaries. Its stores in the northeastern United States were operated by a corporation known as Macy's Northeast, Inc. ("Macy's Northeast"). Its stores in the southeastern United States were operated by Macy's South, Inc. ("Macy's South"). Macy's Northeast and Macy's South operated department stores, all bearing the "Macy's" name.

On January 27, 1992, Macy's and certain of its subsidiaries filed petitions for reorganization under Chapter 11 of the Bankruptcy Code (App. A at 4a). Macy's attempted to come out of bankruptcy on its own, but it was unable to do so.

Federated then acquired Macy's with the agreement and approval of the Macy's creditors and the U.S. Bankruptcy Court. On September 8, 1994, the Bankruptcy Court approved an agreement of merger between Federated and Macy's, under the terms of which Macy's would be the surviving corporation, and would immediately

change its name to Federated (App. A at 4a). The new company continued to operate the businesses unchanged.

c. Creation of Macy's East

As part of the reorganization approved by the Bankruptcy Court, a new subsidiary, Macy's East, was organized on December 13, 1994, for the purpose of operating the businesses of Macy's Northeast and Macy's South, which were merged into Macy's East upon their emergence from bankruptcy on December 19, 1994, in mergers qualifying as tax-free reorganizations under Internal Revenue Code ("IRC") section 368(a)(1)(A) ("A Reorganization") (App. A at 41a). *Macy's East operated under the tax identification number that Macy's Northeast had previously used.*

Macy's East continued to operate the same stores previously operated by Macy's Northeast and Macy's South, under the Macy's name, and carried the same merchandise (App. A at 4a-5a). Since the stores continued exactly the same operations they always had, customers perceived no difference.

Jordan Marsh and A&S, which had already been operationally combined but had maintained separate legal identities, were merged in an A Reorganization into Macy's East on August 26, 1995 (App. A at 5a). Macy's East continued, and continues, to operate the same retail stores in Massachusetts and elsewhere that Jordan Marsh operated for more than 100 years.

2. The Accumulated NOLs

During their years of operation as separate corporations, until their mergers into Macy's East, Jordan Marsh, Macy's Northeast, Macy's South and A&S had accumulated significant NOLs. The NOLs available to Macy's East for the fiscal year ended February 1, 1997 ("year in issue"), on a company-by-company basis were as follows (App. I at 112a):

Corporation	NOLs Available By Company
Macy's Northeast	$309,154,296
Macy's South	115,308,047
Jordan Marsh	217,330,350
A&S	79,449,853

3. Policy Concerns Mandating the Use of NOLs

Professor Richard D. Pomp, one of the nation's foremost authorities on state and local tax matters, was accepted as an expert in tax policy. He testified and submitted a report (App. H at 88a-104a) regarding the tax policy implications surrounding the Department's regulation and concluded that "from a tax policy perspective, the regulation embodies a philosophy that has long been rejected at the federal level. Moreover, the regulation is inconsistent with national bankruptcy policy, inconsistent with federal tax policy, and elevates form over substance by disregarding economic reality" (App. H at 88a). Further, he found that "[f]rom a policy perspective, the Department's approach cannot be justified" and that "no principled policy considerations [could be found] in favor of the

Department's interpretation of the regulation" (App. H at 104a).

Federal tax policy regarding reorganizations militates against the regulation, Professor Pomp testified. The theoretical underpinning of the Internal Revenue Service's ("Service") treatment of reorganizations is that "the new corporation is substantially a continuation of the old" (App. H at 95a). Thus, under the Internal Revenue Code and Massachusetts tax law, reorganizations are nontaxable events. Professor Pomp testified that the Department's regulation, which would deprive a corporation of its NOLs if it is not the survivor in a reorganization, is contrary to the federal goal of neutrality regarding reorganizations and to the basic federal tax tenet that the substance of the transaction and not its form governs the taxation of a transaction.

Professor Pomp also discussed considerations in the adoption of regulations. He explained that when a state tax department promulgates an interpretive regulation, its interpretation cannot be inconsistent with the statute, "so if the statute says something is A, the regulation can't say it's B." In Professor Pomp's view, the Department's regulation at issue here does precisely that. Furthermore, he concluded that the regulation also "draws a meaningless distinction between economically equivalent transactions" (App. H. at 92a).

He observed that the purpose of the Bankruptcy Code is to rehabilitate the debtor, and that the ability to carry forward NOLs, valuable assets of the debtor, fosters that purpose (App. H. at 93a). The Department's denial of Macy's East's right to use the NOLs generated by its predecessors-in-interest increased the tax cost of the

rehabilitative Bankruptcy Court-confirmed reorganization and therefore runs counter to national bankruptcy policy. He also posited that "unless [there are] compelling reasons, a state ought not to thwart national policies." Despite the absence of compelling reasons, the Department's interpretation of the regulation does just that, he concluded.

Professor Pomp also observed that the Department's position here is inconsistent with its published position in Letter Ruling 95-4 (Mass. Dep't of Revenue Mar. 31, 1995) (App. G at 84a-87a) ("Ruling 95-4"), in which a taxpayer that had reorganized pursuant to IRC section 368(a)(1)(F) was allowed to utilize the NOLs of its predecessor, even though the situation in the ruling and that here are "substantively exactly the same in terms of the essence and the economics of the transaction."

Professor Pomp stated that the "same pragmatic interpretation" (App. H. at 103a) that the Department applied in Ruling 95-4 should be applied here. Since Macy's East "is the embodiment and continuation of the merged retail stores" (App. H at 102a), those stores should be viewed by the Department as if they had survived the merger. At a minimum, he concluded, *Macy's East should be considered a continuation of Macy's Northeast, the company that earned the income in the year in issue that Massachusetts is trying to tax* (*Id.* (emphasis added)). That approach would not require that the regulation be declared invalid (*Id.*).

4. Income Based on Separate Accounting

Mr. Richard Genetelli, Macy's East's expert accounting witness, performed an analysis of the separate operations

actually conducted by Macy's East in Massachusetts in the year at issue (App. I at 105a-132a). This analysis reveals that the stores doing business in Massachusetts incurred an aggregate loss of $28,935,890, and that, of the 11 stores, all but one of them were operating at significant losses (App. I at 112a).

5. Massachusetts' Denial of Macy's East's Utilization of the NOLs

On its original corporate excise tax ("CET") return for the year at issue, Macy's East reported income subject to apportionment of $195,024,436. It paid CET in the amount of $1,743,466, of which $1,349,808 was the income portion (App. I at 108a). Adjustments for federal audit changes of $6,184,831 increased Macy's East's apportionable income to $201,209,267 (App. I at 110a, 113a).

The entire $201 million of income was earned outside Massachusetts through the operations of stores formerly operated by Macy's Northeast and Macy's South. The components of the $201 million of income for the year at issue are as follows:

Corporation	Income (Loss)
Macy's Northeast	$193,528,537
Macy's South	48,635,434
Jordan Marsh	(31,049,442)
A&S	(6,018,835)

Macy's East (new stores)	(3,886,427)[3]
Total	$201,209,267

(App. I at 125a).

On May 8, 1998, Macy's East filed an Application for Abatement and an amended return seeking refund of $1,349,808, due to the utilization of the Jordan Marsh NOLs (App. D at 24a). A second amended return was filed with the Department on August 20, 1999, claiming the losses from Macy's Northeast and Macy's South and a third amended return claiming the NOLs from A&S, was filed on April 13, 2000. The Department denied each of the claims (App. D. at 24a n.1).

6. The Proceedings Below

How the federal questions were raised and passed on below. In Macy's East's petition to the Massachusetts Appellate Tax Board ("Board"), and in its briefs filed with the Board and the Massachusetts Supreme Judicial Court, Macy's East contended that the Commissioner's deprivation of its right to utilize the NOLs from the Predecessor Companies violated the Supremacy, Due Process, Commerce and Equal Protection Clauses of the United States Constitution. Macy's East also raised, and the Board and the Massachusetts Supreme Judicial Court passed on, the question of whether the Commissioner was required to follow federal tax principles, including this Court's "continuity of business enterprise" doctrine announced in *Libson Shops, Inc. v. Koehler,* 353 U.S. 382 (1957).

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[3] These losses were attributable to stores not in existence prior to the formation of Macy's East.

The decisions below. Macy's East filed timely Applications for Abatement seeking refunds of overpayments of Massachusetts CET paid attributable to its inadvertent failure to utilize the NOLs of the Predecessor Companies to reduce its income. Upon the Commissioner's denial of the Applications for Abatement, Macy's East timely filed its petition with the Board. The Board concluded that Macy's East's argument that the Bankruptcy Code and Supremacy Clause principles were violated "lacked merit" (App. D at 40a). The Board also held that " 'Massachusetts is not required to follow Federal procedure with respect to this matter' " (App. D at 29a (citation omitted)).

Macy's East timely filed its Notice of Appeal with the Massachusetts Appeals Court. After briefing to the Massachusetts Appeals Court was complete, the Massachusetts Supreme Judicial Court, *sua sponte*, took the appeal directly (App. B at 19a), and affirmed the Board's decision (App. A at 1a). In so doing, the Massachusetts Supreme Judicial Court addressed each of Macy's East's constitutional claims, *i.e.*, Supremacy, Due Process, Commerce and Equal Protection, and rejected each. Although the Massachusetts Supreme Judicial Court made no reference to *Libson Shops*, it considered whether federal principles should govern its decision. After acknowledging that " 'Massachusetts tax statutes and the [IRC] are inextricably interwoven' " (App. A at 9a (citation omitted)), and that the legislative history regarding federal conformity is "inconclusive" (App. A at 11a), the Supreme Judicial Court nonetheless held that Massachusetts law departs from federal law with respect to NOLs (App. A at 9a).

REASONS FOR GRANTING THIS PETITION

I. BY DEPRIVING MACY'S EAST OF ONE OF ITS VALUABLE PROPERTY RIGHTS OF ITS ESTATE IN BANKRUPTCY – ITS NET OPERATING LOSSES – THE LOWER COURT VIOLATED THE SUPREMACY CLAUSE

The Framers of the United States Constitution recognized the importance of a uniform system of dealing with bankruptcy and they gave Congress exclusive jurisdiction over insolvencies. U.S. Const. art. I, § 8, cl. 4. As James Madison stated: "The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question." The Federalist No. 42 (James Madison).

The Supremacy Clause of the United States Constitution provides that "[t]his Constitution, and the Law of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. Accordingly, since the bankruptcy law is explicitly authorized by the Constitution, the Supremacy Clause prohibits the States from enacting laws which are contrary to Congressionally enacted bankruptcy law.

When Congress enacted Chapter 11 of the Bankruptcy Reform Act of 1978, its goal was to ensure that a corporation could reorganize so that it might "continue to operate,

provide its employees with jobs, pay its creditors, and produce a return for its stockholders." H.R. Rep. No. 95-595, at 220 (1978).

The largest assets a bankrupt estate may have are its NOLs. *Russell v. United States (In re Russell),* 927 F.2d 413 (8th Cir. 1991); *Official Comm. of Unsecured Creditors v. PSS S.S. Co. (In re Prudential Lines, Inc.)*, 928 F.2d 565 (2d Cir. 1991), *aff'g* 119 B.R. 430 (Bankr. S.D.N.Y. 1990). The bankruptcy court in *Prudential Lines* summed it up well: "The right to use a NOL carryover to obtain favorable tax treatment is of value to an ongoing business and is certainly something of value to the debtor as part of a reorganization plan. When creditors go unpaid due to the very losses giving rise to the NOL, they ought to be able to realize the value of a NOL carryover as property of the bankruptcy estate upon reorganization." 119 B.R. at 432.

Chapter 11 reorganizations require the approval of the bankruptcy court and the debtor's creditors (11 U.S.C. sections 101-1330). To the extent the NOLs which are disclosed in the plan of reorganization are disallowed by the states, a creditor's ability to make informed decisions regarding the plan is compromised. The confirmed plan of reorganization, which culminated in the formation of Macy's East, disclosed the existence of NOLs and made financial projections contingent upon their availability. Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code for the Second Amended Joint Plan of Reorganization of R.H. Macy & Co., Inc. and Certain of its Subsidiaries, *In re R.H. Macy & Co.*, No. 92 B 40477 (Bankr. S.D.N.Y.). The reorganization process will be severely undermined if creditors can be arbitrarily deprived of the ability to evaluate a plan's tax attributes by state tax auditors.

Federal tax law furthers the intent of Chapter 11 with provisions that facilitate the successful reorganization of insolvent businesses. For example, while forgiveness of debt will give rise to income in a non-bankruptcy context, debt discharged in bankruptcy will not require the realization of income. IRC § 108(a)(1)(A). Another example is the relaxation of the NOL limitation provisions of IRC section 382. The Internal Revenue Code even provides for a special type of tax-free reorganization for certain corporations that transfer their assets in bankruptcy. IRC § 368(a)(1)(G). The Federal government allowed Macy's East to use all of the disputed NOLs at issue here.

The Bankruptcy Act and the Internal Revenue Code evidence Congressional policy to aid insolvent corporations that are trying to reorganize and come out of bankruptcy. The Massachusetts Supreme Judicial Court's denial of Macy's East right to utilize its valuable assets, its NOLs, is irreconcilable with and frustrates that intent.

The controlling principle in Supremacy Clause jurisprudence is that "any state legislation which frustrates the full effectiveness of federal law is rendered invalid." *Perez v. Campbell*, 402 U.S. 637, 652 (1971). Federal bankruptcy legislation trumps any inconsistent state law. Robert E. Ginsberg & Robert D. Martin, *Ginsberg & Martin on Bankruptcy*, § 1.01(F) (4th ed. 1999) (citing *International Shoe Co. v. Pinkus*, 278 U.S. 261 (1929); *In re Chicago Rapid Transit Co.*, 129 F.2d 1, 4 (7th Cir.), *cert. denied*, 317 U.S. 683 (1942)). Congress intended Chapter 11 of the Bankruptcy Code to "revive the debtors' businesses and thereby preserve jobs and protect investors" and to "maximiz[e] the value of the bankruptcy estate." *Toibb v. Radloff*, 501 U.S. 157, 163 (1991).

Macy's East was the successor-in-interest to Macy's Northeast and Macy's South. Under the Plan of Reorganization, Macy's East was required to pay all of the prepetition claims of Macy's Northeast and Macy's South. If Macy's East is responsible for the payment of the liabilities of these predecessor corporations, it should not be deprived of the use of the NOLs or any other assets of those corporations.

The Massachusetts Supreme Judicial Court decision upholding the Commissioner's denial of Macy's East's NOLs violated the Supremacy Clause by trying to destroy substantial assets of Macy's East's bankrupt estate – its NOLs. The Commissioner's regulation which was the basis for the denial restricts the Bankruptcy Court judges' ability to restructure companies by imposing an arbitrary rule that the corporation with the NOLs must survive in order to preserve its NOLs for future use. Bankruptcy judges' hands cannot be so tied without violating the Supremacy Clause.

II. THE LOWER COURT IMPROPERLY IGNORED THE "CONTINUITY OF BUSINESS ENTERPRISE" PRINCIPLE SET OUT BY THIS COURT IN *LIBSON SHOPS*, ADDING TO THE CONFLICT AMONG MANY STATES AS TO WHETHER *LIBSON SHOPS* MUST BE FOLLOWED

The Massachusetts Supreme Judicial Court has itself acknowledged that the "'Massachusetts tax statutes and the [Internal Revenue Code] are inextricably interwoven'" and recognized that the legislative history is inconclusive regarding the treatment of NOLs where, as here, a new entity continues the business enterprises of corporations which merge into it (App. A. at 9a (citation omitted)).

Despite the dearth of authority to support departure from federal tax statutes and principles, including this Court's "continuity of business enterprise" principle set out in *Libson Shops, Inc. v. Koehler,* 353 U.S. 382 (1957), the Massachusetts Supreme Judicial Court opted to deprive Macy's East of assets that were part and parcel of its bankruptcy estate simply because it – and not the corporations that generated the NOLs and were merged into Macy's East – was the surviving entity to the bankruptcy reorganization. By its decision, moreover, the Massachusetts Supreme Judicial Court adds to the confusion amongst the courts around the country that have considered the issue. Direction from this Court clarifying whether states are free to ignore the *Libson Shops* precepts regarding utilization of NOLs in merger situations is needed.

A. The Massachusetts Court Should Have Applied this Court's *Libson Shops* Doctrine and/or Federal Tax Law to Macy's East

Prior to the enactment of IRC section 172 in 1954, the courts adopted a pure entity theory in determining whether NOL carryovers survived. Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders*, ¶ 14.02[2] (6th ed. 1998). Thus, in *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 441 (1934), this Court held that a newly created corporation that succeeded to the assets and continued to operate the business of the loss corporation was not entitled to the NOLs generated by such loss corporation since it was not the "same taxpayer" that sustained the loss. Recognizing that this decision had exalted form over substance, well-advised taxpayers arranged their reorganizations to

ensure that the loss corporation (and its loss carryovers and other tax attributes) survived. However, the entity doctrine served to deny carryforwards to successor corporations after mergers, consolidations, creditors' reorganizations, and reincorporations in the same or different states. Comment, *Net Operating Loss Carryover and Corporate Adjustments: Retaining an Advantageous Tax History Under Libson Shops and Sections 269, 381, and 382,* 69 Yale L.J. 1201, 1208 (1960).

Perhaps because of the nonsensical results that the entity theory produced, this Court limited its vitality. In *Helvering v. Metropolitan Edison Co.*, 306 U.S. 522, 529 (1939), this Court adopted a merger of identity by operation of law approach and concluded that a *de facto* merger "has all the elements of a merger and comes within the principle that the corporate personality of the transferor is drowned in that of the transferee" and, accordingly, allowed the successor to deduct unamortized bond discount related to the transferor.

In *Libson Shops*, this Court expanded the equation by requiring that, even in a merger situation, a "continuity of business enterprise" must exist. 353 U.S. at 386. Basically, the test that this Court imposed was whether "[b]ut for the merger, the old corporation itself would have been entitled to a carry-back." *Id.* at 388. Revenue Ruling 59-395, 1959-2 C.B. 475, was issued to provide guidance as to when the Internal Revenue Service would consider one business substantially the same as another. The Service stated that, if there were a statutory merger or a consolidation, it would look to whether the losses were to be used to offset income of the resulting corporation that was attributable to the assets acquired by it from the absorbed constituent

entity and whether the assets were used to continue the business operated by the absorbed corporation.

Thus, under this Court's *Libson Shops* doctrine, Macy's East would be allowed to use the NOLs of the Predecessor Companies, because Macy's East continued the business enterprises formerly carried on by its Predecessors.

In *Libson Shops*, this Court also expressed concern that a taxpayer could receive a "windfall" merely because of a merger with another corporation. 353 U.S. at 389. Congress was also concerned, and responded by enacting into the 1954 IRC sections 381 and 382. Internal Revenue Code section 381 provides that certain tax attributes of a corporation survive a corporate reorganization, while IRC section 382 limits the availability of NOL carryovers where certain continuity-of-business and continuity-of-ownership requirements are not met. These provisions complemented IRC section 269, which provides that the Service can disallow the carryover of NOLs if the principal purpose for the acquisition of stock was tax avoidance. This provision, which was enacted in 1943, was targeted at curbing stock or asset purchases where the principal motivation was to secure beneficial tax attributes. Revenue Act of 1943, 58 Stat. 47, § 128 (1943) (which added section 139 to the 1939 Internal Revenue Code).

The mergers of Macy's Northeast, Macy's South, Jordan Marsh and A&S into Macy's East can hardly be said to involve the "trafficking" of NOLs. In addition, since Bankruptcy Code, title 11 of the United States Code section 1129(d), prohibits the Bankruptcy Court from confirming a plan of reorganization if the "principal purpose of the plan is the avoidance of taxes," and since

both the Federated and Macy's plans of reorganization were confirmed by the Bankruptcy Court, tax avoidance could not have been their motivation.

For federal purposes Macy's East was permitted to carry forward the NOLs from each of the corporations that were merged into it – Macy's Northeast, Macy's South, Jordan Marsh and A&S. Such treatment is not only permitted but is required by IRC section 381(a)(2), which states that the acquiring corporation "shall succeed to and take into account" NOL carryovers (subject to certain conditions and limitations) "in a transfer . . . if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D), (F), or (G) of section 368(a)(1)."

The Massachusetts Supreme Judicial Court has deviated from its oft-espoused precept of conformity to federal tax law in determining the application of State tax provisions. As the Supreme Judicial Court has recognized, there is "a legislative intent, running through many State tax provisions, to assure uniformity between State and Federal taxation." *Dow Chem. Co. v. Commissioner of Revenue*, 378 Mass. 254, 264, 391 N.E.2d 253, 258 (1979) (footnote omitted). Indeed, the Court has acknowledged the IRC to be "the fundamental source of tax law in the Commonwealth." *Commissioner of Revenue v. Northeast Petroleum Corp.*, 401 Mass. 44, 49, 514 N.E.2d 359, 362 (1987). Recently, in *General Mills, Inc. v. Commissioner of Revenue*, 440 Mass. 154, 795 N.E.2d 552 (2003), *cert. denied*, 124 S. Ct. 1878 (2004), the Massachusetts Supreme Judicial Court, the same court that rendered the decision below, relied on the Federal treatment under IRC section 338(h)(10), and Massachusetts conformity to such Federal treatment, despite a lack of explicit statutory

authority addressing whether Massachusetts will recognize elections made under that section.

Under both the current federal tax provisions and *Libson Shops*, Macy's East would be allowed to use the NOLs of the Predecessor Companies. The Massachusetts Supreme Judicial Court's reliance upon Commissioner's regulation derogates federal tax law and is contrary to its own recognition that Massachusetts' tax provisions strongly favor conformity with federal tax law.

B. The Decision of the Massachusetts Court Adds to the States' Confusion as to the Continuing Viability of the *Libson Shops* Doctrine and Invites this Court's Clarification

The Massachusetts Supreme Judicial Court decision adds to the confusion amongst the states as to whether the *Libson Shops* doctrine has vitality and must be applied in situations where the tax provisions are silent as to whether a corporation that succeeds to the business of its predecessors is entitled to succeed to the NOLs which were generated by those predecessors.

Courts in Arizona, Arkansas, Connecticut, Georgia, North Carolina and Oregon, which like Massachusetts do not specifically address by statute the availability of NOLs in a merger, have adopted the *Libson Shops* continuity of business test. *See, e.g., State Tax Comm'n of Ariz. v. Oliver's Laundry & Dry Cleaning Co.*, 508 P.2d 107, 112 (Ariz. Ct. App. 1973) (court found that the Arizona statute, which had no provision regarding the continuing availability of NOLs following a merger, allowed use of NOLs in merger situations "to the extent that the losses being used [are] to offset the subsequent gains from the same business unit");

Bracy Dev. Co. v. Milam, 252 Ark. 268, 478 S.W.2d 765 (1972) (adopting the *Libson Shops* doctrine explicitly); *Thermatool Corp. v. Department of Revenue Servs.*, 43 Conn. Supp. 260, 651 A.2d 763 (1994) (after an extensive review of the historical developments of NOL utilization agreed that *Libson Shops'* functional approach should prevail over the formalistic, separate entity approach); *Chilivis v. Studebaker Worthington, Inc.*, 137 Ga. App. 337, 223 S.E.2d 747 (1976) (looking to the continuity of business enterprise test in the absence of the statute's incorporation of IRC section 381); *Fieldcrest Mills, Inc. v. Coble*, 290 N.C. 586, 227 S.E.2d 562 (1976); *Tiffany-Davis Drug Co. v. Department of Revenue*, 255 Or. 279, 465 P.2d 878 (1970) (applying *Libson Shops* to allow the successor to use the losses of the merged entities to offset the income of the successor to the extent attributable to the businesses generating the losses).

Some states – Montana, Tennessee, Texas and Wisconsin– appear to have rejected or limited the applicability of *Libson Shops. See, e.g., GBN, Inc. v. Montana Dep't of Revenue*, 249 Mont. 261, 815 P.2d 595 (1991) (without citing to *Libson Shops,* court refused to allow a surviving corporation in a merger to use the NOLs of a corporation which merged into it based on the statutory language adopting a separate entity approach to NOL utilization); *Little Six Corp. v. Johnson*, No. 01-A-01-9806-CH-00285, 1999 Tenn. App. LEXIS 334 (Tenn. Ct. App. May 28, 1999) (rejected *Libson Shops* on basis of that there was no evidence of legislative intent to follow); *Sergeant Enters., Inc. v. Strayhorn*, 112 S.W.3d 241 (Tex. App. 2003) (without citing to *Libson Shops,* court adopted a separate entity approach); *Fall River Canning Co. v. Wisconsin Department of Taxation*, 3 Wis. 2d 632, 89 N.W.2d 203 (1958)

(rejecting *Libson Shops* as unhelpful and holding fast to the separate entity theory to disallow the survivor in a merger the use of NOLs of merged entities).

Perhaps most confusing are states, such as New Jersey, that apparently cannot decide whether or not to follow the *Libson Shops* doctrine. While New Jersey's highest court criticized the lower court for "attempt[ing] to discredit *Libson,*" suggesting that it agreed with this Court's "continuity of business analysis," *Richard's Auto City, Inc. v. Director, Division of Taxation,* 140 N.J. 523, 537, 659 A.2d 1360, 1367 (1995), the lower court nonetheless ignored *Libson Shops* when again faced with the issue of availability of NOLs in merger situations. *A.H. Robins Co. v. Director, Div. of Taxation,* 365 N.J. Super. 472, 839 A.2d 914 (App. Div. 2004), *certif. granted,* C-954, 2004 N.J. LEXIS 682 (N.J. May 6, 2004) (currently on review to the New Jersey Supreme Court).

While states are free to enact tax laws that explicitly limit NOLs availability, where there is no explicit statutory provision and the states' tax laws conform to federal tax law, the *Libson Shops* doctrine and IRC section 381 should apply. This case presents an opportunity for this Court to shed light on an issue that continues to confound taxpayers, taxing authorities and courts.

III. SINCE MACY'S EAST SUFFERED LOSSES IN MASSACHUSETTS, TAXATION OF THE INCOME EARNED OUTSIDE OF MASSACHUSETTS VIOLATES THE DUE PROCESS AND COMMERCE CLAUSES

A. This Court Has Held Repeatedly That States May Not Tax Values Earned Outside Their Borders.

In another example of states' "heads I win, tails you lose" approach to income allocation,[4] the Massachusetts Supreme Judicial Court ignored the evidence that established that Macy's East's operations in Massachusetts generated no income. The closing of a court's eyes to the facts – when those facts prove that the state is attempting to tax values earned outside its borders – is not justice. More importantly, it is not constitutional.

It is among the most fundamental precepts of state taxation that a non-domiciliary state may not tax values earned outside it. A tax on interstate activities will withstand scrutiny under the Due Process and Commerce Clauses of the U.S. Constitution only if there exists "a 'minimal connection' or 'nexus' between the interstate activities and the taxing State, and 'a rational relationship between the income attributed to the State and the intrastate values of the enterprise.'" *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 219-20 (1980) (quoting

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[4] Basically the approach works as follows: States will rely upon statutory allocation formulas when it suits them, *see, e.g., Unisys Corp. v. Pennsylvania*, 571 Pa. 139, 812 A.2d 448 (2002), *cert. denied*, 124 S. Ct. 54 (2003), and will force taxpayers to use alternative allocation formulas if using an alternative method results in more tax revenue, *see, e.g., Union Pac. Corp. v. Idaho State Tax Comm'n*, 136 Idaho 34, 28 P.3d 375 (2001), *aff'd on appeal after remand*, 83 P.3d 116 (Idaho 2004).

Mobil Oil Corp. v. Commissioner of Taxes of Vt., 445 U.S. 425, 436, 437 (1980)); *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982) ("As a general principle, a State may not tax value earned outside its borders."). Where no such connection exists, the state has not "given anything for which it can ask return." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 445 (1940); *see also ASARCO*, 458 U.S. at 315; *Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n*, 390 U.S. 317, 326-30 (1968).

As this Court stated in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169-70 (1983):

> [A]n apportionment formula must, under both the Due Process and Commerce Clauses, be fair. . . . The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not have its source in the taxing State. . . . " Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in the State' or has 'led to a grossly distorted result.'"

(Citations omitted.)

Thus, as this Court has consistently recognized, where an apportionment formula – whatever that formula might be – apportions income to a state "out of all appropriate proportion" to the business conducted, the Constitution has been violated. That is precisely what occurred here – a result that begs this Court's intervention.

B. Separate Accounting Remains a Valuable Measuring Tool.

The Massachusetts Supreme Judicial Court claims that the Commissioner was "free to reject" Macy's East's separate accounting (App. A. at 17a). The Massachusetts Supreme Judicial Court misunderstands the nature of the separate accounting introduced by Macy's East. Rather than being precluded by a unitary business, a separate accounting test measures whether formulary apportionment, when applied to a unitary business, arrives at a roughly correct result.

This is exactly what New Jersey tried to do in *Allied-Signal, Inc. v. Director, Div. of Taxation,* 504 U.S. 768, 784 (1992), and was not permitted to do by this Court, which held:

> To be sure, our cases give States wide latitude to fashion formulae designed to approximate the in-state portion of value produced by a corporation's truly multistate activity. But that is far removed from New Jersey's theory that any business in the State, no matter how small or unprofitable, subjects all of a corporation's out-of-state income, no matter how discrete, to apportionment.

In a decision that has stood the test of time, this Court relied on the results of a separate accounting in *Hans Rees' Sons v. North Carolina ex rel. Maxwell,* 283 U.S. 123, 135 (1931), to find that North Carolina's apportionment method attributed to the state a percentage of income out of all appropriate proportion to the business transacted within the state.

In *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978), this Court rejected a challenge to the application of

Iowa's apportionment formula, finding that the taxpayer had not demonstrated that out-of-state income was being taxed. This Court specifically noted that "the record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of the company's operations." *Id.* at 272.

In *Container*, this Court recognized that some percentage of distortion would be unconstitutional, although it did not find that percentage to be reached. 463 U.S. at 184. The Massachusetts Supreme Judicial Court accepts without question the Commissioner's rejection of the separate accounting method, ignoring this Court's decision in *Hans Rees'*. Separate accounting is a valuable method of testing an apportionment formula, and the Massachusetts Supreme Judicial Court was wrong to ignore it.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: August 20, 2004

APPENDIX A

COMMONWEALTH OF MASSACHUSETTS

SUPREME JUDICIAL COURT FOR THE COMMONWEALTH

AT BOSTON, May 27, 2004

IN THE CASE NO. SJC-09194

MACY'S EAST, INC.

vs.

COMMISSIONER OF REVENUE

pending in the Appellate Tax Board No. F-251009

ORDERED, that the following entry be made in the docket, viz., –

The decision of the Appellate Tax Board is affirmed.

BY THE COURT,

/s/ Susan Mellen, CLERK.

May 27, 2004

SJC-09194

MACY'S EAST, INC. *vs.*
COMMISSIONER OF REVENUE.

Suffolk. April 6, 2004. – May 27, 2004.

Present: Marshall, C.J., Greaney, Ireland, Spina, Cowin, Sosman, & Cordy, JJ.

Taxation, Corporate excise, Deduction from income. *Corporation*, Merger, Reorganization. *Constitutional Law*, Taxation, Supremacy of Federal law, Commerce clause. *Words*, "Gross income," "Net income."

Appeal from a decision of the Appellate Tax Board.

The Supreme Judicial Court on its own initiative transferred the case from the Appeals Court.

Paul H. Frankel, of New York (*Maxwell D. Solet* with him) for the taxpayer.

Thomas K. Condon (*Christopher M. Glionna* with him) for Commissioner of Revenue.

GREANEY, J. We transferred this case to this court on our own motion to decide whether, under Massachusetts law, the taxpayer, Macy's East, Inc. (Macy's East), may carry forward and deduct, for State corporate excise tax purposes, premerger net operating losses (NOLs), generated by four entities it absorbed in various mergers. The Appellate Tax Board (board) concluded that Macy's East may not carry forward and deduct these NOLs, and affirmed the Commissioner of Revenue's (commissioner's) denial of Macy's East's applications for abatement and amended corporate excise tax returns for the taxable

period that ended February 1, 1997 (taxable period). We affirm the decision of the board.

The board found the following facts.[1] See G. L. c. 58A, § 13 ("The decision of the board shall be final as to findings of fact"). During the taxable period, Macy's East was a corporation organized under Ohio law, and had its headquarters in New York. Macy's East is engaged in the business of operating retail department stores. During the taxable period, Macy's East operated eleven retail stores in Massachusetts, which previously had been operated as Jordan Marsh Stores Corporation (Jordan Marsh) retail stores.

Macy's East was the surviving corporation after a series of corporate reorganizations occurring between 1986 and 1994. One party to this series of reorganizations, Federated Department Stores, Inc. (Federated), was formed as a holding company by several department stores, including Abraham & Straus (A&S). On May 3, 1988, Campeau Corporation, which owned Jordan Marsh, acquired Federated. On January 15, 1990, Federated and some of its subsidiaries, including Jordan Marsh, filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code, in the United States Bankruptcy Court for the Southern District of Ohio.

On February 4, 1992, Federated emerged from bankruptcy pursuant to a plan of reorganization. Federated continued to conduct its retail business through the operation of its subsidiaries Jordan Marsh and A&S.

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[1] In some instances, the findings have been supplemented with additional undisputed facts from the record.

Jordan Marsh operated retail department stores in Massachusetts, and A&S operated retail department stores primarily in New York.

On July 15, 1986, R.H. Macy & Company, Inc. (Macy's), then known as Macy Acquiring Corporation, acquired the former R.H. Macy & Company, Inc. (former Macy's), a retail department corporation, in a leveraged buyout. On January 27, 1992, Macy's, and some of its subsidiaries, filed petitions in bankruptcy for reorganization under Chapter 11 of the Bankruptcy Code, in the United States Bankruptcy Court for the Southern District of New York. Macy's continued to conduct its retail business through the operation of several subsidiaries, the principal subsidiaries being Macy's Northeast, Inc. (Macy's Northeast), and Macy's South, Inc. (Macy's South). Both Macy's Northeast and Macy's South were corporations organized under Delaware law.

On September 8, 1994, a Bankruptcy Court judge of the United States Bankruptcy Court for the Southern District of New York approved an agreement of merger between Federated and Macy's, pursuant to which Macy's would emerge as the surviving corporation of the combined company and would change its name to Federated. As part of the reorganization plan, Macy's East was created on December 13, 1994. Macy's East was organized for the purpose of operating the businesses of Macy's Northeast and Macy's South, which merged into Macy's East on their emergence from bankruptcy on December 14, 1994. Macy's East operated under the tax identification number previously used by Macy's Northeast. Unlike Macy's Northeast and Macy's South, the new Macy's East emerged as a corporation organized under Ohio law. Macy's East operated its business in both the northeastern and the southeastern

regions of the country, districts which previously had been operated separately by Macy's Northeast and Macy's South, respectively. Prior to this merger, Macy's Northeast and Macy's South had accumulated NOLs during their 1991 through 1995 fiscal years.

On August 26, 1995, Jordan Marsh and A&S were absorbed into Macy's East. The directors and officers of Macy's East became the directors and officers of the merged corporation, and each previously issued and outstanding share of A&S and Jordan Marsh common stock were canceled and retired. After the merger, Macy's East operated the retail stores previously owned by Jordan Marsh and A&S. A&S had not conducted business in Massachusetts. Before the merger, Jordan Marsh and A&S had accumulated NOLs during their 1991 through 1995 fiscal years.

On May 8, 1998, Macy's East filed with the commissioner an application for abatement and an amended combined corporate excise tax return for the taxable period showing an overpayment of tax and requesting a refund of the income portion of the corporate excise equal to $1,349,808. Macy's East attributed the requested refund amount to the use of NOL carryforwards previously incurred by Jordan Marsh during its 1991 through 1995 fiscal years. The commissioner denied the application for abatement on October 27, 1998, on the ground that a regulation, promulgated in 1993, 830 Code Mass. Regs. § 63.30.2(11) (1993) (quoted in its entirety, *infra*), prohibits a surviving corporation of a merger to deduct or carry forward the NOLs of a corporation it absorbs. Macy's East then filed various amended returns for the taxable period seeking to deduct premerger NOLs attributable to A&S, Macy's Northeast, and Macy's South.

After further proceedings that need not be detailed, an evidentiary hearing was held before the board. The board rendered a decision in favor of the commissioner, and subsequent to that decision, issued its written findings and conclusions. The board noted that the Massachusetts corporate excise tax statutory scheme, contrary to the Federal scheme, retains the individual tax attributes of each entity subject to the tax, and concluded that Macy's East failed to meet its burden of proving that it qualified for the statutory deduction for using the premerger NOLs incurred by other corporations. The board further concluded that its interpretation was supported by the commissioner's reasonable regulation interpreting the statute, and rejected several constitutional challenges to the regulation. This appeal followed.

1. "We will not reverse a decision of the board 'if it is based on substantial evidence and on a correct application of the law.'" *Bill DeLuca Enters., Inc.* v. *Commissioner of Revenue,* 431 Mass. 314, 315 (2000), quoting *Koch* v. *Commissioner of Revenue,* 416 Mass. 540, 555 (1993). Macy's East argues that the board incorrectly determined that the Massachusetts corporate excise tax provisions do not allow it to deduct the premerger NOLs of Jordan Marsh, A&S, Macy's Northeast, and Macy's South. The statutory provision at the heart of this dispute is G. L. c. 63, § 30(5)(*a*), as appearing in St. 1992, c. 133, § 403, and is called, for our purposes, the Massachusetts net operating loss provision or Massachusetts NOL provision. Before defining that provision, a brief overview of the State corporate excise tax scheme is in order.

General Laws c. 63, § 32, as amended through St. 1988, c. 202, § 14; § 38; and § 39, as amended through St. 1990, c. 150, § 349, impose an excise tax on domestic and

foreign corporations. A portion of that tax is based on a corporation's net income derived from business activities carried on in Massachusetts. § 38. The starting point for calculating a corporation's net income involves first calculating a corporation's "gross income." See § 30(4), as amended through St. 1992, c. 133, §§ 401, 402.[2] General Laws c. 63, § 30(3), defines "[g]ross income," as that term is "defined under the provisions of the Federal Internal Revenue Code [I.R.C.] as amended and in effect for the taxable year" with some exceptions not relevant here. Following the determination of a corporation's gross income, its "net income" must be calculated. "Net income" is defined in G. L. c. 63 as "gross income less the deductions, but not credits, allowable under the provisions of the [I.R.C.] as amended and in effect for the taxable year." G. L. c. 63, § 30(4). The definition of "[n]et income" also provides:

> "Deductions with respect to the following items, however, shall not be allowed: –
>
> (i) dividends received(;)
>
> (ii) *[l]osses sustained in other taxable years, except for the net operating losses as provided in paragraph five of this section*(;)
>
> (iii) taxes on or measured by income, franchise taxes measured by net income, franchise

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[2] Former paragraph 5 was "hereby further amended by striking out . . . the designation '(*b*)' and inserting in place thereof the designation: 4 [and] striking out the subparagraph (ii) and inserting in place thereof the following subparagraph: – 'Losses sustained in other taxable years, except for the net operating losses as provided in paragraph five of this section.'" St. 1992, c. 133, §§ 401, 402.

> taxes for the privilege of doing business and capital stock taxes imposed by any state" (emphasis added).

Id. See note 2, *supra.*

The relevant portion of the 1992 version of G. L. c. 63, § 30(5), provides:

> "For purposes of this chapter, the Massachusetts net operating loss incurred in a taxable year shall mean the amount by which the deductions allowed under paragraph four, including the dividends-received deduction allowed in section thirty-eight (*a*)(1) and not including the deductions for net operating losses under this paragraph, exceed gross income for the taxable year as defined in paragraph three of this section."

There is no dispute that, for Federal tax purposes, the relevant, and then applicable, provisions of the I.R.C. allowed Macy's East to carryforward and deduct the NOLs at issue. Under the Federal scheme, I.R.C. § 172 is the basic NOL provision, and identifies and allows NOL carryovers and carrybacks. See 26 U.S.C. § 172(a) (2000) ("There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of [1] the net operating loss carryovers to such year, plus [2] the net operating loss carrybacks to such year").[3] I.R.C. § 381(a) provides for, subject to certain limitations, the carryover of NOLs (under I.R.C.

[3] The Federal net operating loss (NOL) is defined as "the excess of the deductions allowed . . . over the gross income. Such excess shall be computed with the modifications specified in subsection (d)." 26 U.S.C. § 172(c).

§ 172) in I.R.C. § 332 liquidations of subsidiaries (I.R.C. § 381[a][1]) and in certain tax-free organizations under I.R.C. § 368(a)(1), specifically, those "reorganization[s]" defined in subparagraphs (A), (C), (D), (F), and (G) (I.R.C. § 381[a][2]). 26 U.S.C. § 381. Of the qualifying reorganizations for NOL carryforwards under I.R.C. § 381(*a*)(2), is a "statutory merger or consolidation," or Type A reorganization, see I.R.C. § 368(*a*)(1)(A), which Macy's East states (and no one disputes) is the type of merger that took place with respect to each of the absorbed entities in this case (Macy's Northeast, Macy's South, Jordan Marsh, and A&S).

The issue presented in this case is whether, under the *Massachusetts* NOL provision, Macy's East may similarly use (carry forward and deduct) the premerger NOLs of corporations it absorbed. Macy's East does not argue that the State NOL provision expressly allows a surviving corporation to deduct the premerger NOLs of an absorbed corporation in a statutory merger. (Macy's East cannot advance such an argument because the Massachusetts NOL provision is silent on the matter.) Rather, Macy's East argues that there is no language in the Massachusetts NOL provision, or in its legislative history, that supports departure from the Federal NOL tax provisions.

While the "Massachusetts tax statutes and the [I.R.C.] are inextricably interwoven," *Commissioner of Revenue* v. *Franchi,* 423 Mass. 817, 819 (1996), Massachusetts tax law can and does depart from Federal tax law, particularly in matters authorizing deductions for prior year's losses, see *Bill DeLuca Enters., Inc.* v. *Commissioner of Revenue, supra* at 325 (noting that "[t]he Massachusetts Legislature has consistently chosen to treat excess deductions from a previous tax year in a different manner from the I.R.C. . . .

These statutes evince a persistent and conscious legislative decision to take a different path from that of the Federal government in ameliorating the transactional inequities that arise from annual taxation"). See also *Farrell Enters., Inc.* v. *Commissioner of Revenue,* 46 Mass. App. Ct. 564, 572 (1999) (noting that "the Massachusetts statute and regulations regarding combined returns do not follow the Federal regulations regarding the filing of consolidated income tax returns which explicitly permit the NOL carry forwards of all of the members to be aggregated and made available in the calculation of a group's consolidated income").[4] Also, in this case, the legislative history is inconclusive. Although, as Macy's East correctly points out, a direct reference to I.R.C. § 172 in G. L. c. 63, § 30(4)(ii), was deleted in 1992, compare St. 1988, c. 202, § 10 (disallowing deductions for "losses sustained in other taxable years; provided, however, that net operating losses as defined in [I.R.C. § 172] as amended and in effect for the taxable year of the losses which are sustained in taxable years ending on or after December [31, 1989], shall be allowed"), with St. 1992, c. 133, §§ 402, 403 (deleting above language quoted above in St. 1988, c. 202, § 10, and inserting the language in G. L. c. 63, § 30[5], that is at issue in this case), the Massachusetts NOL definition that was adopted by the 1992 legislation, unlike I.R.C.

[4] We reject Macy's East's attempt to distinguish *Farrell Enters., Inc.* v. *Commissioner of Revenue,* 46 Mass. App. Ct. 564, 572 (1999), on the ground that Macy's East "is a continuation of the entities that generated the NOLs." The board's findings indicate that it rejected any such implicit claim, and Macy's East does not identify sufficient evidence to demonstrate that the board's findings on the issue are unsupported by substantial evidence.

§ 381(a)(2), does not plainly authorize a surviving corporation in a merger to use NOLs generated by the entities it absorbed.

As correctly recognized by the board, Macy's East overlooks the significance of what it is seeking, namely, a deduction. "We have frequently recognized that an exemption from taxation 'is a matter of special favor or grace,' and that statutes granting exemptions from taxation are therefore to be strictly construed." *South Boston Sav. Bank* v. *Commissioner of Revenue,* 418 Mass. 695, 698 (1994), citing *State Tax Comm'n* v. *Blinder,* 336 Mass. 698, 703 (1958) ("an exemption [is] . . . to be recognized only where the property falls clearly and unmistakably within the express words of a legislative command"). "The burden is on the taxpayer to demonstrate entitlement to an exemption claimed." *South Boston Sav. Bank* v. *Commissioner of Revenue, supra.* Where the statute is silent concerning the deduction Macy's East is attempting to claim, and the legislative history inconclusive, we agree with the board's conclusion that Macy's East "failed to meet its burden of proving that it qualified [for the deduction] under the terms of the statute."

2. Macy's East correctly construes the Massachusetts NOL provision as creating an exception to the State disallowance of the Federal NOL deduction. Macy's East also correctly notes that "[n]owhere in [the Massachusetts NOL provision] does it say that a deduction should or should not be allowed." However, despite the fact that the commissioner is authorized to promulgate regulations "necessary to interpret and enforce any statute imposing any tax, excise or fee," G. L. c. 14, § 6, Macy's East contends that the commissioner's regulation, which unambiguously prohibits the carryforward of the type attempted

here, is invalid because it "imposes a limitation not authorized by the statute" and because the department has interpreted the regulation in an arbitrary and nonuniform manner. We reject these contentions.

The commissioner's regulation reads as follows:

> "(a) *Mergers.* In the event of a merger of two or more corporations, the surviving corporation retains any net operating loss that it separately incurred before the merger, subject to the limitations of 830 [Code Mass. Regs. §] 63.30.2(11)(b). All of the net operating loss of a corporation absorbed in the merger is lost. The surviving corporation may not deduct or carry over the net operating loss of a corporation it absorbs. In the event of a consolidation of two or more previously existing corporations into a new corporation, the new corporation starts with no net operating loss. All of the net operating loss of the previously existing corporations is lost. The new corporation may not deduct or carry over any net operating loss incurred by any of the previously existing corporations before the consolidation.
>
> "(b) *Changes in Ownership.* Where a corporation undergoes an ownership change, as defined in [I.R.C.] § 382(g), the amount of the corporation's net income that may be offset by pre-change net operating loss in any taxable year shall not exceed the limitation imposed by [I.R.C.] § 382, provided that the limitation shall be adjusted for differences between Massachusetts taxable net income and federal taxable income determined without regard to the federal net operating loss deduction. The adjustment

> shall be made for each taxable year by multiplying the [I.R.C.] § 382 limitation by Massachusetts taxable net income, determined without regard to the net operating loss deduction, and dividing the resulting amount by federal taxable income, determined without regard to the federal net operating loss deduction. Any amount of net operating loss that cannot be deducted because of the limitation may be carried over as provided in 830 [Code Mass. Regs. §] 63.30.2(7)."

830 Code Mass. Regs. § 63.30.2(11) (regulation). The regulation was adopted contemporaneously (specifically, on January 1, 1993) with the enactment of the amendment to the Massachusetts NOL provision that rewrote paragraph 5, see St. 1992, c. 133, §§ 402, 403, and deleted reference to I.R.C. § 172. So long as consistently interpreted thereafter, the commissioner's position is entitled to some deference because the Legislature has delegated to the commissioner the responsibility of administering, interpreting, and enforcing the State tax laws, in resolving statutory ambiguity, or silence as in this case. See G. L. c. 14, § 6; *First Fed. Sav. & Loan Ass'n* v. *State Tax Comm'n,* 372 Mass. 478, 485 (1977).

Macy's East does not argue that the board erred in determining that, under paragraph (a) of the regulation, the creation of Macy's East by the merger of Macy's Northeast and Macy's South constituted "a consolidation of two or more previously existing corporations into a new corporation," and that the subsequent merger of Jordan Marsh and A&P into Macy's East constituted "a merger of two or more corporations." The board correctly concluded that the commissioner's regulation was a reasonable interpretation of the corresponding statutory provisions, G. L. c. 63, § 30(4) and § 30(5), and that the regulation's "denial of the

deductions at issue is consistent with the complete body of Massachusetts tax law, namely the statutes and cases interpreting those statutes, which establishes the Commonwealth's corporate tax structure as adopting an individual-entity approach." See *Farrell Enters., Inc.* v. *Commissioner of Revenue,* 46 Mass. App. Ct. 564, 572 (1999). Further, due to the differences between "A" and "F" reorganizations as defined in I.R.C. § 368(a)(1)(A) (reorganizations involving "a statutory merger or consolidation") and I.R.C. § 368(a)(1)(F) (reorganizations involving "a mere change in identity, form, or place of organization of one corporation, however effected"), and the specifics surrounding the mergers in this case, the commissioner could reasonably treat, in one of its letter rulings, NOLs from that transaction (an F reorganization) differently. Thus, the commissioner's different treatment of the NOLs of a particular F reorganization in one set of limited and distinguishable factual circumstances does not render the commissioner's tax treatment "arbitrary" or "non-uniform" as Macy's East contends. Macy's East's various arguments concerning the incorporation, in paragraph (b) of the commissioner's regulation, of I.R.C. § 382 limitations, overlook the complexity of the Federal NOL scheme and the considerable discretion afforded to the commissioner to enact regulations interpreting or enforcing the statutes imposing the State corporate excise tax.[5] Surely, where Congress has distinguished various

[5] The same can be said of Macy's East's argument concerning the commissioner's treatment of NOLs in reorganizations defined under I.R.C. § 368(a)(1)(F) (reorganizations involving "a mere change in identity, form, or place of organization of one corporation, however effected").

forms of reorganizations, permitting NOL carryovers only with respect to certain types of reorganizations, see I.R.C. § 381(a)(2), and applying the limitations in I.R.C. § 382,[6] in the case of ownership changes occasioned by an "equity structure shift," to only some of the types of reorganizations defined in I.R.C. § 381, see I.R.C. § 382(g)(3)(A), the commissioner may also rationally treat various types of reorganizations differently. As correctly noted by the board, "the [r]egulation's reference to [I.R.C.] § 382 does not speak to the deduction of losses sustained in prior years by a *different* taxpayer" (emphasis added).

A few remaining points should be stated. Macy's East cites to law in other jurisdictions as support for its position. E.g., *Chilivis* v. *Studebaker Worthington, Inc.*, 137 Ga. App. 337 (1976). Cf. *Richard's Auto City, Inc.* v. *Director, Div. of Taxation,* 140 N.J. 523 (1995). The law in other jurisdictions, however, cannot serve as a source for interpreting the Massachusetts NOL provision and corresponding regulation. As one commentator explained, "The [S]tate NOL rules vary quite markedly. While some [S]tates follow the [F]ederal provisions regarding the carryback and carryforward of NOLs, other [S]tates do not .... The [S]tate rules regarding utilization of NOLs after a merger or acquisition also vary significantly and can be quite complex." Lippman, 1200 Tax Management Multistate Tax Portfolios, Income Taxes: State Treatment of Net Operating Losses at 1200.03.B1 (1999). Along those lines, while we are aware, as noted by Macy's East's expert on

[6] In general terms, I.R.C. § 382 imposes limitations on a corporation's use of its NOLs following certain corporate ownership changes. See 26 U.S.C. § 382.

tax policy matters at the hearing, that the commissioner's treatment of premerger NOLs in this case "embodies a philosophy that has long been rejected at the [F]ederal level" and has been the subject of much criticism, see Joyner, Some State Corporate NOL Carryovers are still Governed by Outdated Federal Doctrine, 4 J. Multistate Tax'n 260 (1995), such policy matters are appropriately left for consideration by the Legislature, see *Bill DeLuca Enters., Inc.* v. *Commissioner of Revenue,* 431 Mass. 314, 325 & n.16 (2000). We find significance in the fact that, since the regulation went into effect in 1993, the Legislature, which is assumed to know of the regulation, see *Gillette Co.* v. *Commissioner of Revenue,* 425 Mass. 670, 680-681 (1997), has not amended the statute to trump the regulation by expressly permitting a surviving corporation's use of carryforwards and deductions of premerger NOLs of the corporations it absorbed.

3. The board correctly rejected Macy's East's constitutional challenges to the regulation. Macy's East's claims, that, because the NOLs were an "asset" of the bankruptcy estates of each of the debtor corporations, the regulation violates the supremacy clause of the United States Constitution because it "divests Macy's East of one of its most significant assets – the NOLs of the [absorbed] [c]orporations" ignores that "[t]he nature and extent of the debtor's interest in property is determined by applicable non-bankruptcy law," *In re Prudential Lines Inc.,* 928 F.2d 565, 569 (2d Cir.), cert. denied, 502 U.S. 821 (1991), or State law, see *Butner* v. *United States,* 440 U.S. 48, 54 (1979). Because Macy's East may not, under State law, carryforward and deduct the NOLs of Macy's Northeast, Macy's South, Jordan Marsh, and A&S, those NOLs are not property subject to be included in Macy's East's

bankruptcy estate. Thus, there is no deprivation of any property interest.

In rejecting Macy's East's claims of due process and commerce clause violations under the United States Constitution, the board correctly concluded that Macy's East failed to produce "clear and cogent evidence" of extraterritorial taxation when its income was subject to apportionment according to the Legislature's approved, three-factor statutory formula. See *Gillette Co.* v. *Commissioner of Revenue, supra* at 680-681. Macy's East overlooks that the evidence it offered in support of its claims constituted calculations based on a separate accounting analysis, an accounting method that the commissioner was free to reject. See *Becton, Dickinson & Co.* v. *Department of Revenue,* 383 Mass. 786, 787 (1981).

Finally, the board correctly concluded that Macy's East did not satisfy its formidable burden of demonstrating that the commissioner's distinction between "A" and "F" reorganizations defined under I.R.C. § 368(a)(1), and as applied to the facts of this case, violated equal protection principles. See *Nashoba Communications Ltd. Partnership* v. *Assessors of Danvers,* 429 Mass. 126, 128 (1999). As explained by the board, "F" reorganizations typically involve only one business enterprise that emerges essentially unchanged from the reorganization, as opposed to "A" reorganizations which typically involve multiple corporations with only one surviving corporation and the others no longer existing. That an F reorganization may sometimes "overlap" with other types of reorganizations under I.R.C. § 368(a)(1), has no bearing on the particular facts of this case. We are satisfied that, in the context of this case, there are meaningful distinctions between the two types of reorganizations.

4. We affirm the decision of the board.

So ordered.

APPENDIX B

COMMONWEALTH OF MASSACHUSETTS
SUPREME JUDICIAL COURT
FOR THE COMMONWEALTH

ORDER

It is hereby Ordered, that the following appeal, now pending in the Appeals Court, be transferred, sua sponte, to the Supreme Judicial Court for the Commonwealth:

Appeals Court No. 2003-P-0109

MACY'S EAST INC
vs.
COMMISSIONER OF REVENUE

The provisions of Massachusetts Rules of Appellate Procedure, Rule 11(g), are applicable to the filing of briefs.

By the Court,

/s/ Jane Kenworthy Lewis
Jane Kenworthy Lewis
Assistant Clerk

ENTERED: January 22, 2004

APPENDIX C

THE COMMONWEALTH OF MASSACHUSETTS
Appellate Tax Board
[LOGO] *399 Washington Street*
Boston, Massachusetts 02108

Docket No. F251009

MACY'S EAST, INC.,
Appellant.

COMMISSIONER OF REVENUE,
Appellee.

DECISION

The decision is for the appellee.

APPELLATE TAX BOARD

By Abigail A. Burns Chairman.
Frank Scharaffa Member.
Donald E. Gorton III Member.
Nancy T. Egan Member.
_____ Member.

Attest: [ILLEGIBLE]
Clerk of the Board

Date: APR 30, 2002
(Seal)

NOTICE: An appeal may be taken to the Massachusetts Appeals Court by either party to these proceedings. A claim of appeal should be filed with this Board in accordance with the Massachusetts Rules of Appellate Procedure.

APPENDIX D

COMMONWEALTH OF MASSACHUSETTS APPELLATE TAX BOARD

MACY'S EAST, INC. v. **COMMISSIONER OF REVENUE**

Docket No. F251009

Promulgated: November 5, 2002

This is an appeal filed under the formal procedure pursuant to G.L. c. 62C, § 39 from the refusal of the appellee to abate corporate excise assessed against the appellant under G.L. c. 63, § 38 for the taxable period ended February 1, 1997.

Commissioner Scharaffa heard the appeal and was joined in the decision for the appellee by Chairman Burns and Commissioners Gorton, Egan, and Rose.

These findings of fact and report are made at the requests of the appellant and the appellee pursuant to G.L. c. 58A, § 13 and 831 CMR 1.32.

Paul H. Frankel, Esq., Hollis L. Hyans, Esq., Amy F. Nogid, Esq., Michael A. Pearl, Esq. and *Maxwell D. Solet, Esq.*, for the appellant.

Thomas Condon, Esq. and *Elisabeth DiTomassi*, Esq., for the appellee.

FINDINGS OF FACT AND REPORT

On the basis of testimony and exhibits offered at the hearing of this appeal, the Appellate Tax Board ("Board") made the following findings of fact. The appellant, Macy's East, Inc. ("Macy's East"), is a corporation organized under the laws of Ohio with its headquarters in New York.

Macy's East is engaged in the business of operating retail department stores in Massachusetts. During the taxable period ended February 1, 1997 ("tax year at issue"), Macy's East operated eleven retail stores in Massachusetts. These stores had previously been operated as Jordan Marsh Stores Corporation ("Jordan Marsh") retail stores.

The appellant was the surviving corporation after a series of corporate reorganizations occurring between 1986 and 1994. One party to this series of reorganizations, Federated Department Stores, Inc. ("Federated"), was formed as a holding company by several department stores including Abraham & Straus ("A&S"). On May 3, 1988, Campeau Corporation, which owned Jordan Marsh, acquired Federated in a hostile takeover. On January 15, 1990, Federated and certain of its subsidiaries including Jordan Marsh filed for bankruptcy protection under Chapter 11. On February 4, 1992, Federated emerged from bankruptcy pursuant to a plan of reorganization. Federated continued to conduct its retail business through the operation of its subsidiaries, Jordan Marsh and A&S. Jordan Marsh operated retail department stores in Massachusetts. A&S operated retail department stores primarily in New York.

On July 15, 1986, R.H. Macy & Company, Inc. ("Macy's"), then known as Macy Acquiring Corporation, acquired the former R.H. Macy & Company, Inc. ("former Macy's"), a retail department corporation, in a leveraged buyout. On January 27, 1992, Macy's and certain of its subsidiaries filed petitions in bankruptcy for reorganization under Chapter 11. Macy's continued to conduct its retail business through the operation of several subsidiaries, the principal subsidiaries being Macy's Northeast, Inc. ("Macy's Northeast") and Macy's South, Inc. ("Macy's

South"). Both subsidiaries were organized under the laws of Delaware.

On September 8, 1994, the Bankruptcy Court approved an Agreement of Merger between Federated and Macy's, pursuant to which Macy's would emerge as the surviving corporation of the combined company and would change its name to Federated. As part of the reorganization plan, the appellant, Macy's East, was organized on December 13, 1994, for the purpose of operating the businesses of Macy's Northeast and Macy's South, which merged into Macy's East upon their emergences from bankruptcy on December 14, 1994. Macy's East operated under the tax identification number previously used by Macy's Northeast. Unlike Macy's Northeast and Macy's South, the new Macy's East emerged as a corporation organized under the laws of Ohio. Moreover, this new corporation operated its business in both the northeastern and the southeastern regions of the country, districts which had been operated separately by Macy's Northeast and Macy's South, respectively. Prior to this merger, Macy's Northeast and Macy's South had accumulated net operating losses during their 1991 through 1995 fiscal years.

On August 26, 1995, Jordan Marsh and A&S were absorbed into Macy's East, which began operating the retail stores previously owned by those former entities. Pursuant to the Agreement of Merger, entered as an exhibit in this appeal, the directors and officers of Macy's East became the directors and officers of the merged corporation, and each previously "issued and outstanding share" of A&S and Jordan Marsh Common Stock were "canceled and retired." Jack Cox, Operating Vice President and Assistant Secretary of Federated, testified at the

hearing that prior to its merger into Macy's, A&S was not qualified to conduct business in Massachusetts, nor did it conduct any business in the Commonwealth. Prior to the merger, Jordan Marsh and A&S had accumulated net operating losses during their 1991 through 1995 fiscal years.

Macy's East timely filed a Massachusetts combined corporation excise return for the tax year at issue and paid the corporate excise shown thereon in the amount of $1,743,466, of which $1,349,808 was the income portion of the excise. On May 8, 1998, Macy's East filed an application for abatement and an amended return for the tax year at issue showing an overpayment of tax and requesting a refund of the income portion of the corporate excise equal to $1,349,808, which it attributed to the use of net operating loss carryforwards previously incurred by Jordan Marsh during its 1991 through 1995 fiscal years. By Notice of Abatement Determination dated October 27, 1998, the Commissioner of Revenue ("Commissioner") denied the appellant's application for abatement.[1] On

[1] On August 19, 1999, the appellant then filed a second amended return for the tax year at issue seeking to carry forward additional net operating losses that it had sustained in previous tax years and net operating loss carryforwards attributable to Macy's Northeast and Macy's South prior to the December 19, 1994 merger. On April 13, 2000, Macy's East then filed a third amended return for the tax year at issue seeking to carry forward additional net operating losses attributable to A&S prior to the August 26, 1995 merger. Macy's East then revised Schedules E and E-2 of the third amended return to recalculate the amount of available net operating loss carryforwards to coincide with the method set forth in Regulation 830 CMR 63.30.2(7).

Although the second and third amended returns and the revisions to Schedules E and E-2 showed increased amounts of net operating loss carryforwards available to the appellant, the amount of abatement requested for the tax year at issue remained the same as the amount

(Continued on following page)

December 18, 1998, the appellant filed a Petition Under Formal Procedure with the Board.[2] Based on this evidence, the Board found that it had jurisdiction over this appeal.

The issue in this appeal is whether the Commissioner properly denied the appellant the use of net operating loss carryforwards that were generated by corporations other than the appellant. Specifically, the net operating loss carryforwards at issue were generated by Macy's South and Macy's Northeast, which merged to form Macy's East, and by Jordan Marsh and A&S, which were absorbed by Macy's East. For the reasons explained in the following Opinion, the Board found that the Commissioner properly denied the net operating loss carryforwards at issue. Accordingly, the Board issued a decision for the appellee in this appeal.

OPINION

Domestic and foreign corporations that conduct business in the Commonwealth are required to pay a corporate excise based in part on their net income derived from business activities carried on in Massachusetts. G.L. c. 63, §§ 32, 38, and 39. The "gross income" of a corporation for Massachusetts tax purposes is generally equal to gross

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denied by the Commissioner in the Notice of Abatement Determination, because the appellant had requested abatement of the entire income portion of the corporate excise on its application for abatement filed on May 8, 1998.

[2] On April 13, 2000, Macy's East filed an application for abatement for the tax year at issue challenging the application of the non-income measure of the corporate excise. The Commissioner denied this application for abatement by Notice of Abatement Determination dated June 9, 2000. The denial of that application for abatement is not raised by this petition but may be the subject of future litigation.

income as defined under the Internal Revenue Code ("Code") as amended and in effect for the taxable year with some exceptions not relevant to this appeal. G.L. c. 63, § 30(3). The "net income" of a corporation for Massachusetts tax purposes is equal to gross income minus many of the deductions allowable under the Code but with several notable exceptions contained in G.L. c. 63, § 30(4).

The exception at issue in this appeal is the denial of a deduction for "[l]osses sustained in other taxable years, except for the net operating losses as provided in paragraph five of this section." G.L. c. 63, § 30(4)(ii). Paragraph five of G.L. c. 63, § 30 defines net operating losses as follows:

> For purposes of this chapter, **the Massachusetts net operating loss** incurred in a taxable year **shall mean** the amount by which the deductions allowed under paragraph four, including the dividends-received deduction allowed in section thirty-eight (a)(1) and not including the deductions for net operating losses under this paragraph, exceed gross income for the taxable year as defined in paragraph three of this section.

G.L. c. 63, § 30(5)(a) (emphasis added). The federal net operating loss is created at Code § 172, which provides specific provisions for the carryback and carryforward of these losses to tax years other than the year in which the losses were sustained. *See* Code § 172(b). The parties do not dispute that the relevant provisions of the Code allow Macy's East to carryforward the net operating losses at

issue.[3] However, the parties dispute whether these same principles are applicable to the Massachusetts corporate excise statute.

The taxpayer argued that the language at G.L. c. 63, § 30(5)(a) simply describes an amount but does not create a new Massachusetts net operating loss deduction that differs from the federal net operating loss deduction, and accordingly, Macy's East should be allowed to carry forward the net operating loss deductions accumulated by the acquired corporations prior to their merger to Macy's East. For this proposition, Macy's East relied on the legislative history of § 30(5)(a), which indicates, in the taxpayer's view, that although the reference to Code § 172 in § 30(4)(ii) was deleted, the net operating loss definition adopted was substantially similar to that Code provision. *See* St. 1992, c. 133, §§ 402, 403.

However, Massachusetts courts and this Board have ruled that federal tax concepts are often not dispositive of the interpretation of the Massachusetts corporate excise statute. *See e.g.* ***Rohrbough, Inc. v. Commissioner of Revenue***, 385 Mass. 830, 832 (1982) (finding that gross income on a federal return will not always be the same for state tax purposes), ***Weston Marketing Corp. v. Commissioner of Revenue***, 16 Mass. App. Tax Bd. Rep. 76, 80 (1994), *aff'd*, No. 94-P-1256 (Mass. App. Ct. Mar. 14, 1996) (finding no Massachusetts tax significance attached to "a fictitious transaction deemed to have taken place for

[3] The Code authorizes the carryforward of net operating losses sustained by corporations acquired in statutory mergers. *See* Code § 381(a)(2) (referencing Code § 381(c)(1), which authorizes the survival of "net operating loss carryovers determined under section 172" subject to limitations not at issue in this appeal).

[federal] tax purposes"). Moreover, "[w]here, as here, the language of the statute is clear, it is the function of the judiciary to apply it, not amend it." ***Commissioner of Revenue v. Cargill, Inc.***, 429 Mass. 79, 82 (1999) (quoting ***King v. Viscoloid Co.***, 219 Mass. 420, 425 (1914) ("we have no right to . . . read into the statute a provision which the legislature did not see fit to put there, whether the omission came from inadvertence or of set purpose")). The Board in the present appeal ruled that the statute's specific reference to and definition of the "Massachusetts net operating loss," and its deletion of a reference to Code § 172, evidenced a Legislative intent to create a state-specific concept of "net operating loss" separate and distinct from the federal concept of that term.[4]

The Board found that the taxpayer's interpretation of the statute did not fit into the overall statutory scheme of the Massachusetts corporate excise, which retains the individual tax attributes of each entity subject to tax. For example, unlike the federal consolidated return, the Massachusetts "combined return" calculates the group's combined net income by first determining the taxable net income of each member of the corporate group separately, thereby retaining the individual tax assets and liabilities of each taxpayer before allowing them to file a combined return. G.L. c. 63, § 32B. The Massachusetts courts and this Board have consistently recognized this individual-entity approach and emphasized its distinction from

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[4] *Cf.*, ***Commissioner of Revenue v. Franchi***, 423 Mass. 817, 857 (1996) ("Adopting the Federal interpretation of a statutory term is especially appropriate ***where the corresponding Massachusetts tax law specifically refers us to that interpretation***, as § 1(i) does here when it mandates inclusion of all amounts 'treated as interest . . . [under] other sections of the [I.R.C.].'") (emphasis added).

federal tax law. In ***Farrell Enterprises, Inc. v. Commissioner of Revenue,*** 46 Mass. App. Ct. 564 (1999), the Appeals Court affirmed the Board's finding that, pursuant to the principles of combined accounting in G.L. c. 63, § 32B, net operating losses must be carried forward separately by each member of a combined group, thereby retaining the individual tax attributes of each member of the combined group. In disallowing the taxpayer's deduction of net operating losses incurred by three of its nonprofitable subsidiaries against three of its profitable subsidiaries, the court emphasized the disparate treatment of net operating loss deductions between the federal and Massachusetts tax statutes: "The commissioner concedes [that the Massachusetts combined return law does not follow the Federal consolidated return law with respect to net operating losses] but argues correctly that ***Massachusetts is not required to follow Federal Procedure*** with respect to this matter." ***Id.*** at 572 (emphasis added).

Furthermore, the Supreme Judicial Court has consistently ruled that provisions creating tax deductions are to be construed strictly, and a taxpayer will not prevail on an argument unless it can show itself clearly to come within the terms of the exemption. "We have frequently recognized that an exemption from taxation 'is a matter of special favor or grace,' and that statutes granting exemptions from taxation are therefore to be strictly construed." ***South Boston Savings Bank v. Commissioner of Revenue***, 418 Mass. 695, 698 (1994) (citing ***State Tax Commission v. Blinder***, 336 Mass. 698, 703 (1958) ("an exemption [is] . . . to be recognized only where the property falls clearly and unmistakably within the express words of a legislative command")).

Here, the statute at issue specifically provides a definition for Massachusetts net operating losses, and as indicated by the legislative history, the Legislature specifically deleted the reference to the relevant Code provision. Moreover, the taxpayer could point to no clear statutory language in paragraph five that would specifically adopt the particular federal method of allowing net operating losses of a corporation that does not survive a merger to be carried forward to a corporation other than the one that generated the loss. This point is particularly important because the Supreme Judicial Court has consistently emphasized that Massachusetts tax law often departs from federal tax law, specifically in matters of authorizing deductions for prior year's losses. See ***Bill DeLuca Enterprises v. Commissioner of Revenue***, 431 Mass. 314, 325 (2000) ("The Massachusetts Legislature has consistently chosen to treat excess deductions from a previous tax year in a different manner from the I.R.C. . . . . These statutes evince a persistent and conscious legislative decision to take a different path from that of the Federal government in ameliorating the transactional inequities that arise from annual taxation."). For example, in ***Parker Affiliated Companies v. Commissioner of Revenue***, 382 Mass. 256 (1981), while the Massachusetts corporate excise statute used a gain figure as reported on the federal return, the statute then in effect forbade the taxpayer from deducting carryforwards of net operating loses sustained during previous years by its eighty-percent subsidiary. The Supreme Judicial Court found that the Massachusetts statute "evince[d] a deliberate legislative choice to differentiate State from Federal practice in this area" of loss deductions, and the federal figure served merely "as the starting point for a net income formula unique to Massachusetts" for purposes of calculating tax

basis. ***Id.*** at 262. *See also* ***PMAG v. Commissioner of Revenue***, 429 Mass. 35, 36 (1999) ("The assessment was based on the rationale that, although the Federal tax liability did not change because of the net operating loss, similar deductions were not allowed in Massachusetts for the year in question.").

The Board here concluded that to allow Macy's East to deduct net operating loss carryforwards, which were accumulated by corporations other than Macy's East, would be tantamount to allowing one taxpayer to assume the tax attributes of another in direct contravention of the statute's individual-entity approach. *See* G.L c. 63, § 32B. The body of Massachusetts case law interpreting the corporate excise espouses the denial of net operating loss carryforwards accumulated by corporations other than the taxpayer. *See, e.g.*, ***Farrell Enterprises***, 46 Mass. App. Ct. at 572. Furthermore, while the taxpayer claimed that the statute did not expressly prohibit the deductions in question, the taxpayer nonetheless could point to no express provision granting the loss carryovers in question. Accordingly, the appellant failed to meet its burden of proving that it qualified under the terms of the statute.

The Commissioner's regulation interpreting § 30 provides further support for this result. Contemporaneously with the amendment of paragraph (4)(ii) and the insertion of paragraph (5) in G.L. c. 63, § 30, the Commissioner promulgated 830 CMR 63.30.2 pertaining to net operating loss deductions and the carryover of these deductions to succeeding tax years. Paragraph (11) of this Regulation specifically addresses the issue in this appeal:

> *Mergers.* In the event of **a merger of two or more corporations,** the surviving corporation retains any net operating loss that it separately

> incurred before the merger, subject to the limitations of 830 CMR 63.30.2(11)(b), below. **All of the net operating loss of a corporation absorbed in the merger is lost.** The surviving corporation may not deduct or carry over the net operating loss of a corporation it absorbs. **In the event of a consolidation of two or more previously existing corporations into a new corporation, the new corporation starts with no net operating loss. All of the net operating loss of the previously existing corporations is lost.** The new corporation may not deduct or carry over any net operating loss incurred by any of the previously existing corporations before the consolidation.

830 CMR 63.30.2(11)(a) (emphasis added).

The highlighted portions of this Regulation address the factual circumstances surrounding the appellant's attempt to deduct the net operating losses at issue. The creation of Macy's East by the merger of Macy's Northeast and Macy's South constituted "a consolidation of two or more previously existing corporations into a new corporation," and Macy's East then "absorbed" Jordan Marsh and A&S into itself, becoming the surviving corporation. According to the Regulation, therefore, Macy's East should not be allowed to deduct the net operating losses at issue.

Administrative interpretations of the agency charged with interpreting a statute, adopted contemporaneously with the enactment or amendment of that statute, are to be accorded weight in interpreting that statute. ***Wellington v. Commissioner of Corps. & Tax'n***, 359 Mass. 448, 452 (1971); *see also* ***Kargman v. Commissioner of Revenue,*** 389 Mass. 784, 787 (1983) ("The Commissioner points out that the contemporaneous construction of a

statute by the administrative agency charged with its enforcement is entitled to weight (***American Family Life Assurance Co. v. Commissioner of Ins.***, 388 Mass. 468, 474-475 [*cert. denied*, 464 U.S. 850] (1983), and cases cited), and that this principle has extra force where the administrative interpretation is of long standing, **Dexter v. State Tax Comm'n,** 350 Mass. 380, 386 (1966).").

The Board found that Regulation 830 CMR 63.30.2 is a reasonable interpretation of G.L. c. 63, § 30(4) and (5) and thus entitled to weight in interpreting the net operating loss provisions. The Regulation's denial of the deductions at issue is consistent with the complete body of Massachusetts tax law, namely the statutes and cases interpreting those statutes, which establishes the Commonwealth's corporate tax structure as adopting an individual-entity approach. The corporate excise statute analyzes corporate taxpayers' tax liabilities individually, even in the case of combined tax returns and requires computation of each corporation's income and deductions on an individual basis prior to combination with other separate corporate taxpayers within the combined group. The cases interpreting the requisite statutes consistently deny the deduction of losses accrued by entities other than the taxpayer. *See, e.g.*, ***Farrell Enterprises,*** 46 Mass. App. Ct. at 572. The Commissioner's Regulation at 830 CMR 63.30.2(11)(a), which denies the carryforward of net operating loss deductions to corporations other than the corporations that sustained the losses, is consistent with this long-standing Massachusetts principle of individual-entity taxation. Accordingly, because the Regulation comports with the statutes as interpreted by the courts and this Board, the Board found and ruled that the Regulation is a reasonable interpretation of G.L. c. 63, § 30(4) and (5).

The Board also found that the Commissioner's Regulation was reasonable in distinguishing between tax-free reorganizations pursuant to Code § 368(a)(1)(F) ("F reorganization") and statutory mergers pursuant to Code § 368(a)(1)(A) ("A reorganization"). In its argument, Macy's East referred to ***LR 95-4***, which pertained to net operating losses sustained by a corporation that was considering changing its state of organization pursuant to an F reorganization. As the taxpayer pointed out, the Commissioner in ***LR 95-4*** declared that net operating losses incurred by a corporation would survive after the corporation had entered a tax-free F reorganization. The Commissioner there cited the federal statute at Code § 381(b) allowing for the net operating losses to survive an F reorganization. However, rather than advocating a blanket adoption of all federal principles surrounding the deduction of net operating losses, the Commissioner specified that the F reorganization was "defined as a mere change in identity, form or place or organization, of one corporation," and emphasized the continuity of business activities of the corporation that emerges from this reorganization: "The only change in the activities, operation and structure of the successor corporation will be its state of incorporation. Thus, there is only one ongoing business enterprise and this single enterprise continues essentially unchanged through the proposed reorganization." Accordingly, the prohibition in 830 CMR 63.30.2, which limits the use of net operating loss carryovers in mergers involving two or more corporations, is not applicable to the F reorganization scenario "which by definition involves only one corporation."

By contrast, an A reorganization does not involve a "mere change in identity, form, or place of organization of

one corporation." Code § 368(a)(1)(F). Rather, the A reorganization, defined as "a statutory merger or consolidation," involves a process whereby a corporation becomes a different entity. Code § 368(a)(1)(A). Accordingly, the A reorganization scenario falls squarely within the realm of the 830 CMR 63.30.2(11)(a) prohibition against the carryforward of net operating losses ***between two or more merging corporations.*** The Regulation is reasonable in distinguishing between mergers involving multiple corporations and reorganizations involving only one entity, even if the surviving corporation continues the general business operations of the entity that it acquires, because this policy is consistent with Massachusetts' long-standing individual-entity approach. Moreover, despite the taxpayer's argument, a corporation's identity cannot be blurred merely by the use of a defunct corporation's taxpayer identification number. The decision to allow the reuse of a former taxpayer's identification number is made for administrative purposes and should not have any effect on tax revenues. *See* ***Rev. Rul. 73-526,*** 1973-2 C.B. 404 (broad statutory authority vests in the Secretary the "discretionary authority" to authorize the use of whatever taxpayer identification number is deemed helpful in a given situation).

The taxpayer observed that ***LR 95-4*** cited ***Newmarket Manufacturing Co. v. United States,*** 233 F.2d 493, 496 (1956) and ***Libson Shops, Inc. v. Koehler,*** 353 U.S. 382 (1957) for the propositions that net operating loss carryover provisions "allow a departure from the general system of a strict annual accounting to bring stability to the tax burden of a business with fluctuating years of profit and loss," and "[r]estricting the use of net operating loss carryover to the taxpaying entity that incurred the

loss is a formalistic approach that has been criticized and abandoned at the federal level," respectively. However, the Board found that these principles were taken out of context when applied to the situation in this appeal. The issue in ***LR 95-4*** pertained to the carryover of net operating losses sustained by an individual corporation prior to an F reorganization, where "[t]he only change in the activities, operation and structure of the successor corporation will be its state of incorporation." The question of whether the net operating losses sustained by a corporation prior to its acquisition by a different entity pursuant to an A reorganization is a substantially different issue. Therefore, the Board ruled that the Commissioner's comments in ***LR 95-4*** were not intended to, nor do they, control the outcome of the instant appeal.

Likewise, the Board found unpersuasive the taxpayer's references to ***CG Associates, Inc. v. Commissioner of Revenue,*** 15 Mass. App. Tax Bd. Rep. 28 (1993) and ***Weston Marketing Corp. v. Commissioner of Revenue,*** 16 Mass. App. Tax Bd. Rep. 76 (1994), *aff'd*, No. 94-P-1256 (Mass. App. Ct. Mar. 14, 1996). Macy's East cited these cases as support for its argument that the amendment to G.L. c. 63, § 30(5), by deleting the explicit reference to Code § 172, actually broadened the net operating loss provision by including other Code provisions beyond just Code § 172. However, the Board found that these decisions did not advance the taxpayer's argument. In ***CG Associates,*** the Board found that the Commissioner was attempting to make a distinction between the deductions allowed to S-corporations and C-corporations, a distinction which did not exist in the net operating loss statute in effect at the time and which relied upon a restriction found at Code § 1366, which was not explicitly

referenced by the statute. ***CG Associates***, 15 Mass. App. Tax Bd. Rep. at 30-31. *See also* ***Weston Marketing***, 16 Mass. App. Tax. Bd. Rep. at 82-83 (Board affirming its decision in CG Associates). Likewise, the Board here found that the reliance on Code sections and principles that are not explicitly referenced in the statute could not support the litigant's conclusion.[5]

Furthermore, the denial of net operating loss carryforwards accumulated by now-defunct corporations in the absence of clear statutory language authorizing the deduction is not particularly Draconian compared with the approaches followed by other taxing jurisdictions. In addressing the same issue presented by this appeal, the Supreme Court of New Jersey and the Court of Appeals of Tennessee reached the same conclusion as the Commissioner and disallowed the deduction of net operating loss carryforwards earned by a corporation prior to its acquisition via a statutory merger. Both ***Richard's Auto City, Inc. v. Director, Division of Taxation***, 659 A.2d 1360 (1995), and ***Little Six Corporation v. Commissioner of Revenue***, 1999 Tenn. App. LEXIS 334 (Tenn. Ct. App. 1999), pertain to an appellant, the surviving corporation,

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[5] The taxpayer also argued that the reference to Code § 382, another provision governing net operating losses, in 830 CMR 63.30.2(11)(b), promulgated contemporaneously with the amendment to the net operating loss provisions of G.L. c. 63, § 30(4) and (5), indicated that "the Legislation removing the reference to IRC § 172 was intended to expand its conformity with federal provisions, not to abandon federal provisions." However, the Board did not find this argument to be persuasive, because the Regulation's reference to Code § 382 does not speak to the deduction of losses sustained in prior years by a different taxpayer. Therefore, the Regulation does not alter the long-standing Massachusetts policies promoting strict construction of deduction provisions or the individual-entity approach.

which acquired a corporation that had accumulated large net operating losses during previous tax years. The evidence in both cases indicated that the surviving corporations continued the operations of the acquired corporations. *See* ***Richard's Auto,*** 659 A.2d at 1362 *and* ***Little Six,*** 1999 Tenn. App. LEXIS 334 at *2.

Similar to the statute at issue in these appeals, the New Jersey and Tennessee statutes did not expressly disallow a surviving corporation to deduct the net operating loss carryforwards earned by the acquired corporation. *See* ***Richard's Auto,*** 659 A.2d at 1363 (quoting N.J.S.A. 54:10A-4(k)) *and* ***Little Six,*** 1999 Tenn. App. LEXIS 334 at *5 (quoting Tenn. Code Ann. § 67-4-805(b)(2)(C)(1)). However, in ***Richard's Auto,*** the corresponding Director of Taxation's regulation disallowed the deduction of net operating loss carryforwards that were not directly earned by the corporation,[6] while in ***Little Six,*** it was a Revenue Rule promulgated two years prior to an amendment to the statute that disallowed the net operating loss carryforward deduction.[7]

In ***Richard's Auto,*** the New Jersey Supreme Court found that the regulation coincided with "the broader statutory context in which the NOL provisions of [the corporate business tax] must be assessed." ***Richard's***

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[6] "The net operating loss may only be carried over by the actual corporation that sustained the loss." ***Richard's Auto***, 659 A.2d at 1363 (quoting N.J.A.C. 18:7-5.13(b)).

[7] "Each corporation is considered a separate entity; therefore, in case of mergers, consolidations, etc. no loss carryovers incurred by the predecessor corporation will be allowed as a deduction from net earnings on the tax return of the successor corporation." 1999 Tenn. App. LEXIS 334 at *5 (quoting ***Revenue Rule 1320-6-1.21(2)(d)***).

Auto, 659 A.2d. at 1364. Because the corporate business tax statute as a whole applied the tax on an individual-entity basis, not on a consolidated basis, "[t]he flaw in [the taxpayer's] position is that it would, in effect, give tax recognition to the losses of a non-taxpayer corporation." ***Id.*** (quoting ***United States Steel Corp. v. Director, Div. Of Taxation,*** 186 A.2d 266 (1962), in which the court found no statutory authority for one taxable entity to assume the tax deductions of another entity after a statutory merger). Accordingly, the disallowance of net operating loss carryforwards to be used by corporations other than the ones generating the losses "comports with this basic meaning of [the corporate business tax statute]." ***Id.*** at 1365.

Similarly, the ***Little Six*** court upheld the Revenue Rule as consistent with the individual-entity statutory structure, and particularly with "the legislature's use of the singular form in the phrase 'in the next succeeding year or years in which ***the taxpayer*** has net income.'" 1999 Tenn. App. LEXIS 334 at *6 (emphasis added by Tennessee Court of Appeals). The court thus rejected the taxpayer's "continuity of business enterprise" test and followed the separate entity approach of the Revenue Rule. ***Id.***

Macy's East cited and relied upon a case from the Superior Court of Connecticut, ***Thermatool Corporation v. Department of Revenue Services et al.,*** 651 A.2d 763 (1994), in which the court allowed a successor corporation to carry forward the net operating losses attributable to a merged corporation. However, the Board found that ***Thermatool*** did not assist Macy's East's position, because it was distinguishable from the present appeal on its facts. In ***Thermatool,*** the court adopted the "functional approach"

espoused by the taxpayer here, which "looks to the underlying reality of the situation and the policy concerns of the statute." ***Id.*** at 766. However, the facts of that case indicate that "[t]he assets, employees, customers and stock ownership of the company were unaltered. In fact, it appears from the evidence that the only difference between Thermatool I and the Lazarus-like Thermatool II is the fact that they have different certificates of incorporation." ***Id.*** at 765. By contrast, the record here indicates that, at the very least, the directors, officers, and stock ownership of the acquired entities, Jordan's and A&S, were abolished. Moreover, the operations of A&S were significantly altered by its merger into Macy's East, because prior to that time, it was not qualified to conduct business in the Commonwealth. Therefore, it could not be said that Macy's East was "for all practical purposes, the same business enterprise" as Jordan's and A&S. *See* ***Id.*** at 770. Likewise, the operations of Macy's South and Macy's Northeast were significantly altered by their merger into Macy's East, because prior to that time, the two disappearing corporations operated their businesses in two distinct regions, the southeastern and the northeastern portions of the country, respectively. Accordingly, even aside from the fact that Massachusetts corporation excise is based on an individual-entity approach, as opposed to a "functional" approach, the Board found that ***Thermatool*** was factually distinguishable and thus inapposite.

The Board also found and ruled that the taxpayer's argument that the Regulation violated federal Bankruptcy Code and Supremacy Clause principles, which should preempt the Regulation in this situation, lacked merit. Macy's East apparently believes that, while the federal Bankruptcy Code has not explicitly preempted state law, a

"conflict" has arisen, defined as "when compliance with both state and federal law is impossible . . . or when the state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" ***Michigan Canners & Freezers Ass'n v. Agricultural Mktg. & Bargaining Bd.***, 467 U.S. 461, 469 (1984), *on remand*, 365 N.W.2d 760 (1985) (quoting ***Hines & Davidowitz***, 312 U.S. 52, 67 (1941) (citations omitted). The taxpayer argued that bankruptcy policies favor the use of net operating losses of a corporation's predecessors, because the flexible use of loss deductions enables corporations in bankruptcy to reorganize successfully and thereby continue their operations. As the Supreme Judicial Court has noted, "[p]reemption, however, is not favored, and State laws should be upheld unless a conflict with Federal law is clear." ***Attorney Gen. v. Travelers Ins. Co.***, 385 Mass. 598, 602 (1982), *vacated*, 463 U.S. 1221 (1983), *adhered to*, 391 Mass. 730 (1984), *aff'd sub. nom.* ***Metropolitan Life Ins. Co. v. Massachusetts***, 471 U.S. 724 (1985). In the area of state taxation, the Supreme Judicial Court has found that "[t]he determination to forbid the Federal treatment of loss is clearly within the taxing power and prerogative of the Legislature." ***Parker Affiliated Cos.***, 382 Mass. at 263. Accordingly, "[s]tate law is not preempted merely by reference to some vaguely defined Federal policy, or on the ground that Congress has enacted a statute which is tangentially relevant to the subject at issue." ***Arthur D. Little, Inc. v. Commissioner of Health & Hosps. Of Cambridge***, 395 Mass. 535, 545 (1985) (citations omitted) (quoted in ***Sawash v. Suburban Welders Supply Co.***, 407 Mass. 311, 315 (1990)).

Here, the Board found and ruled that the principles supporting a corporation's emergence from a bankruptcy were only "tangentially relevant" to the tax consequences of a statutory merger pursuant to Code § 368(a)(1)(A). ***Arthur D. Little, Inc.***, 395 Mass. at 545. "[T]he Bankruptcy Code does not address the carryover of net operating losses to successor corporations, which is again left to state and local law." 15-TX12 *Collier on Bankruptcy – 15th Edition Revised* TX12.03[2](d) (Lexis Publishing, 2001)). Rather than rely on tangential issues, the Board found that Massachusetts taxpayers should be entitled to rely on the body of applicable Massachusetts tax principles in making their business decisions. The New Jersey Supreme Court emphasized this concept in ***Richard's Auto City*** when it pronounced:

> Corporate mergers are regulated specifically and must be effectuated in accordance with statutory authorization and with results that are statutorily prescribed. (citations omitted). The business decision to effectuate a corporate merger must be undertaken within the statutory framework. The State, in administering its tax laws, is entitled to assume that "corporate lines are real."

659 A.2d at 1370 (quoting ***Household Finance Corp. v. Director of Div. of Taxation***, 177 A.2d 738, 744 (1962)). Accordingly, the Board found a strong policy against preemption, especially in the facts of this appeal where bankruptcy policy was tangential to the tax consequences of the statutory mergers at issue.

The Board also found and ruled that the appellant failed to meet its burden of proving that the Due Process and Commerce Clauses were violated here. Relying on the calculations prepared by its expert witness, Richard W.

Genetelli, who analyzed each Macy's East Massachusetts store on a separate-accounting basis, the appellant claimed that the denial of net operating loss deductions resulted in taxation in excess of the constitutional threshold, because all but one of the Macy's East Massachusetts stores had generated losses during the year at issue. Macy's East, however, admitted that it reported $201,000,000 of income attributable to Massachusetts for the tax year at issue as calculated according to the Commonwealth's three-factor apportionment formula.

It is well-established that "the taxpayer has the 'distinct burden of showing by "clear and cogent evidence" that [the State tax] results in extraterritorial values being taxed.'" ***Gillette Co. v. Commissioner of Revenue***, 425 Mass. 670, 680 (1997) (quoting ***Container Corp. of America v. Franchise Tax Bd.***, 463 U.S. 159, 164, *reh'g denied*, 464 U.S. 909 (1983)) (other citations omitted). The Legislature has wide latitude to deny deductions. *See* ***Drapkin v. Commissioner of Revenue***, 420 Mass. 333, 343 (1995) ("In general, the Legislature has the authority to determine which deductions will be allowed and what might be perceived to be more equitable considerations are not always controlling. The general rule is that 'deductions are a matter of legislative grace' and a taxpayer has the burden of justifying the allowance of any deduction claimed. . . . ") (quoting ***Markell v. State Tax Comm'n***, 2 Mass. App. Tax Bd. Rep. 75, 78-79 (1983)). Moreover, the taxpayer here was conducting a retail business within the borders of Massachusetts, an activity which falls squarely within the taxing provisions of the corporate excise at G.L. c. 63. *See generally,* ***Truck Renting & Leasing Ass'n v. Commissioner of Revenue***, 433 Mass. 733 (2001). Accordingly, the Board found and ruled that the taxpayer

failed to produce "clear and cogent evidence" of extraterritorial taxation when its income was subject to apportionment according to the Commonwealth's approved, statutory formula.[8] *See* ***Gillette,*** 425 Mass. at 681 ("The three-factor formula adopted by the Legislature in G.L. c. 63, § 38(c), is widely recognized as a fair method of apportioning net income.") (citing ***Becton, Dickinson & Co. v. Department of Revenue,*** 383 Mass. 786, 790 (1981) and ***W.R. Grace & Co. v. Commissioner of Revenue,*** 378 Mass. 577 587-88 (1979)).

Likewise, the Board found and ruled that the taxpayer failed to prove its Equal Protection Clause argument. Macy's East claimed that the disparate treatment accorded A reorganizations and F reorganizations amounted to a violation of Equal Protection standards. However, it is well-established in Massachusetts jurisprudence that a taxpayer who challenges a tax statute on Equal Protection grounds has an especially grave task to accomplish:

> 'A classification by a Legislature of property and persons for the purpose of taxation is not violative of . . . [the equal protection] clause of the Fourteenth Amendment [to the United States Constitution] so long as any basis of fact can be reasonably conceived showing that the distinction upon which it rests has a fair and rational relation to the object sought to be accomplished by the enactment, and so long as, the classification being valid, the State deals equally with all

[8] The taxpayer did not contend that the 8.325 percent apportionment applied to determine its Massachusetts net income (based on a property factor of 13.336, a payroll factor of 6.40 percent, and a sales factor of 6.78 percent) was unfair or defective.

> the members of the same class." . . . **A State's scope of discretion is especially wide in the field of taxation.'**

Nashoba Communications Limited Partnership v. Board of Assessors of Danvers, 429 Mass. 126, 128 (1999) (quoting ***Massachusetts Teachers Ass'n v. Secretary of the Commonwealth***, 384 Mass. 209, 240 (1981) and ***Frost v. Commissioner of Corps. & Taxation***, 363 Mass. 235, 248, *appeal dismissed sub nom.* ***Shaw v. Commissioner of Corp. & Taxation***, 414 U.S. 803 (1973)) (emphasis added). The Board was persuaded by the Commissioner's argument distinguishing A reorganizations from F reorganizations. In particular, F reorganizations involve only one business enterprise which emerges from the reorganization essentially unchanged. By contrast, A reorganizations by their very definition involve multiple corporations and ultimately lead to the demise of one or more corporate entities. *See* Code § 368(a)(1)(A). The Board found that the net operating loss provisions at G.L. c. 63, § 30(4) and (5), as interpreted by 830 CMR 63.30.2(11)(a), have "a fair and rational relation to the object sought to be accomplished," namely, the determination of the amount which a corporation should pay for the right to carry on business in the commonwealth and the corresponding protections afforded by the commonwealth, measured in part by the income generated from the business operations conducted in the commonwealth. *See* G.L. c. 63, §§ 32, 39; *see also* ***Farrell Enterprises***, 46 Mass. App. Ct. at 571, ***GBN, Inc. v. Montana Dep't of Revenue***, 815 P.2d 595, 598 (Mont. 1991) (finding no merit to taxpayer's argument that the denial of net operating loss carryforwards of an acquired corporation sustained prior to merger was an unconstitutional discrimination against the surviving corporation). Accordingly, the

Board found and ruled that the taxpayer failed to meet its burden of proving this issue.

The Board found and ruled that the Commissioner's Regulation, 830 CMR 63.30.2(11)(a) is a reasonable interpretation, which fits the net operating loss deduction created by G.L. c. 63, § 30(4) and (5) into the larger statutory context of Massachusetts taxation concepts in general and the corporate excise in particular. The Board further found and ruled that the Commissioner acted properly in denying the net operating loss deductions claimed by the appellant. Accordingly, the Board issued a decision for the appellee in this appeal.

APPELLATE TAX BOARD

By: /s/ Abigail A. Burns
Abigail A. Burns,
Chairman

A true copy:

Attest: [Illegible]
Clerk of the Board

APPENDIX E

MASSACHUSETTS STATUTE INVOLVED

MASS. GEN. LAWS ch. 63, § 30

Sec. 30. Definitions –

When used in this section and sections thirty-one to fifty-two, inclusive, the following terms shall have the following meanings:

1. *"Domestic corporations,"* every corporation organized under or subject to chapter one hundred and fifty-six, chapter one hundred and fifty-six A, chapter one hundred and fifty-six B or chapter one hundred and eighty which has privileges, powers, rights or immunities not possessed by individuals or partnerships; provided, however, that said term shall not apply to corporations organized under the provisions of section ten of chapter one hundred and fifty-seven, domestic manufacturing corporations as defined in section thirty-eight C, to corporations that qualify as regulated investment companies under section eight hundred and fifty-one of the Federal Internal Revenue Code as amended and in effect for the taxable year, to corporations exempt from taxation under the provisions of section five hundred and one of the federal Internal Revenue Code, as amended and in effect for the taxable year, nor to corporations subject to tax under section two. A mutual holding company subject to chapter one hundred and sixty-seven H, or sections 19F to 19W, inclusive, of chapter 175 or a limited liability company formed under chapter one hundred and fifty-six C which is not classified for the taxable year as a partnership for federal income tax purposes, shall also be considered to be a corporation that is a domestic corporation for purposes of this chapter.

2. *"Foreign corporations"*, every corporation, association or organization established, organized or chartered under laws other than those of the commonwealth, for purposes for which domestic corporations may be organized under chapter one hundred and fifty-six, chapter one hundred and fifty-six A, chapter one hundred and fifty-six B, or sections 19F to 19W, inclusive, of chapter 175 or chapter one hundred and eighty which has privileges, powers, rights or immunities not possessed by individuals or partnerships; provided, however, that said term shall not apply to such corporations, associations or organizations without capital stock as are subject to taxation under section eighteen of chapter one hundred and fifty-seven to foreign manufacturing corporations as defined in section forty-two B, to corporations, associations or organizations that qualify as regulated investment companies under section eight hundred and fifty-one of the federal Internal Revenue Code as amended and in effect for the taxable year, to such corporations, associations or organizations as are exempt from taxation under the provisions of section five hundred and one of the federal Internal Revenue Code; as amended and in effect for the taxable year nor to such corporations, associations or organizations subject to tax under section two; provided, further, that said terms shall apply to a foreign limited liability company as defined in section two of chapter one hundred and fifty-six C, which is not classified for the taxable year as a partnership for federal income tax purposes.

3. *"Gross income"*, gross income as defined under the provisions of the Federal Internal Revenue Code, as amended and in effect for the taxable year, plus the interest from bonds, notes and evidences of indebtedness of any state, including this commonwealth; provided,

however, that gross income of corporations taxable under section thirty-eight B shall, in addition to the foregoing, include a deduction for losses from the sale or exchange of capital assets sustained during the taxable year to the extent allowable by the Federal Internal Revenue Code. The commissioner of energy resources may approve United States patents, which have been issued to Massachusetts corporations or applied for by Massachusetts corporations as useful for energy conservation and related purposes or as useful for alternative energy development and related purposes, provided that such patents are determined by said commissioner to be of economic value, practicable, and necessary for the convenience and welfare of the commonwealth and its citizens. Any income received from the sale, lease or other transfer of tangible, intangible, personal or real property or materials manufactured in the commonwealth subject to such patent shall be deducted. Said deduction shall extend for a period no longer than five years from the date of issuance of the United States patent or the date of approval by the commissioner of energy resources, whichever first expires.

4. *"Net income"*, gross income less the deductions, but not credits, allowable under the provisions of the Federal Internal Revenue Code, as amended and in effect for the taxable year; provided, however, that any deduction otherwise allowable which is allocable, in whole or in part, to one or more classes of income not included in a corporation's taxable net income, as determined under subsection (a) of section thirty-eight, shall not be allowed. In lieu of disallowing any deduction allocable, in whole or in part, to dividends not included in a corporation's taxable net income, five per cent of such dividends shall be includable therein, as provided in said subsection (a) of said section

thirty-eight. A deduction shall be allowed for that portion of wages or salaries paid or incurred for the taxable year equal to the amount of the credit allowable for the taxable year under section fifty-one of the Federal Internal Revenue Code and otherwise disallowed under section two hundred and eighty C of said Code. Deductions with respect to the following items, however, shall not be allowed: –

(i) dividends received

(ii) Losses sustained in other taxable years, except for the net operating losses as provided in paragraph five of this section.

(iii) taxes on or measured by income, franchise taxes measured by net income, franchise taxes for the privilege of doing business and capital stock taxes imposed by any state.

(iv) the deduction allowed by section 168(k) of said Code.

5.(a) For purposes of this chapter, the Massachusetts net operating loss incurred in a taxable year shall mean the amount by which the deductions allowed under paragraph four, including the dividends-received deduction allowed in section thirty-eight (a)(1) and not including the deductions for net operating losses under this paragraph, exceed gross income for the taxable year as defined in paragraph three of this section.

(b) Massachusetts net operating losses which are sustained in taxable years ending on or after December thirty-first, nineteen hundred and eighty-nine, shall be allowed as a deduction in determining net income; provided, further, that such deduction shall be limited to a

percentage of the net income for the taxable year as follows:

(1) twenty-five percent of net income for taxable years ending on or after December thirty-first, nineteen hundred and ninety, and before December thirty-first, nineteen hundred and ninety-one;

(2) fifty percent of the net income for taxable years ending on or after December thirty-first, nineteen hundred and ninety-one, and before December thirty-first, nineteen hundred and ninety-two;

(3) seventy-five percent of net income for taxable years ending on or after December thirty-first, nineteen hundred and ninety-two, and before December thirty-first, nineteen hundred and ninety-three; and

(4) and one hundred percent of net income for taxable years ending on or after December thirty-first nineteen hundred and ninety-three.

Losses sustained in any taxable year may be carried forward for not more than five years and may not be carried back.

(c)(i) For the first five consecutive taxable years of a corporation, measured from the date of its organization, whether or not organized under the laws of the commonwealth, so much of the loss as determined under section one hundred and seventy-two of the Federal Internal Revenue Code, as amended and in effect for the taxable year, and adjusted for any differences between Massachusetts taxable net income and federal taxable income, as is represented by net operating loss carryovers for taxable years ending December thirty-first, nineteen hundred and seventy-five, and thereafter may be deducted;

(ii) provided, however, that such carryover losses shall not be allowed to any corporation fifty percent or more of whose voting stock is owned by another corporation whether or not such owning corporation is taxable in this commonwealth;

(iii) provided further that in the case of a foreign corporation, losses incurred before such corporation becomes subject to tax liability in this commonwealth shall not be allowed;

6. *"Taxable year,"* any fiscal or calendar year or period for which the corporation is required to make a return to the federal government.

7. The value of a corporation's tangible property taxable under clause (1) of subsection (a) of section thirty-two or thirty-nine shall be the book value of such of its tangible property situated in the commonwealth on the last day of the taxable year as is not subject to local taxation nor taxable under section sixty-seven. For purposes of this paragraph, "book value" means the original cost of such property, less the depreciation or amortization taken against such property on the books of the corporation maintained for making financial reports to shareholders. If the commissioner finds that a corporation has transferred its tangible property under clause (1) of subsection (a) of section thirty-two or thirty-nine for the purpose of reducing its excise under this chapter, he may determine the amount of its tangible property taxable under said section on the basis of the average of such tangible property held during the taxable year.

8. The net worth of a domestic business corporation taxable under clause (1) of subsection (a) of section thirty-two shall be such portion of the book value of its total

assets on the last day of the taxable year, less the sum of (1) its liabilities on said date, (2) the book value of its tangible property situated in the commonwealth on said date and subject to local taxation, less the interest of any mortgagee therein, and (3) the book value on said date of its investment in subsidiary corporations organized in the commonwealth which represent eighty percent or more of the voting stock of said corporations, as shall be found by multiplying said amount by such corporation's income apportionment percentage, as determined under the provisions of section thirty-eight. In determining the book value of any asset, the commissioner may disallow any reserve, in whole or in part, established with respect thereto which, in his judgment, is not reasonable and proper.

9. The net worth of a foreign corporation taxable under clause (1) of subsection (a) of section thirty-nine shall be such portion of the book value of its total assets less its liabilities on the last day of the taxable year as the book value of its tangible assets situated within the commonwealth on said date and not subject to local taxation plus the amount of its intangible assets on said date allocable to this commonwealth, as hereinafter determined, bear to the book value of its total assets on said date. The intangible assets allocable to this commonwealth shall be such portion of the book value of its total intangible assets on the last day of the taxable year, less the book value on said date of its investment in and advances to subsidiary corporations not doing business in the commonwealth which represent eighty per cent or more of the voting stock of said corporations, as shall be found by multiplying said amount by such corporation's income apportionment percentage, as determined under the provisions of section

thirty-eight. In determining the book value of any asset, the commissioner may disallow any reserve, in whole or in part, with respect thereto which, in his judgment, is not reasonable and proper. For the purpose of this paragraph, "advances" shall mean such interests in a corporation where a corporation-shareholder relationship exists, determined under such regulations as the commissioner may issue and under the provisions of section three hundred and eighty-five of the Federal Internal Revenue Code as amended and in effect for the taxable year and the regulations issued thereunder.

10. "Tangible property corporation", a corporation whose tangible property situated in the commonwealth on the last day of the taxable year and not subject to local taxation is ten percent or more of such portion of its total assets on the last day of the taxable year less those assets as are situated in the commonwealth on the last day of the taxable year and are subject to local taxation, and, for a foreign corporation, less its investment on said date in foreign corporations not registered to do business nor doing business in the commonwealth, as shall be found by multiplying said amount by such corporation's income apportionment percentage, as determined under the provisions of section thirty-eight, or a corporation which, in the judgment of the commissioner, should be so classified. For the purpose of this paragraph, the assets of the corporation shall be valued at their book value.

11. "Intangible property corporation", a corporation whose tangible property situated in the commonwealth on the last day of the taxable year and not subject to local taxation is less than ten percent of such portion of its total assets on the last day of the taxable year less those assets as are situated in the commonwealth on the last day of the

taxable year and are subject to local taxation, and, for a foreign corporation, less its investment on said date in foreign corporations not registered to do business nor doing business in the commonwealth, as shall be found by multiplying said amount by such corporation's income apportionment percentage, as determined under the provisions of section thirty-eight, or a corporation which, in the judgment of the commissioner, shall be so classified. For the purpose of this paragraph, the assets of the corporation shall be valued at their book value.

12. In any case in which the effective date or applicability of any provision of this chapter is expressed in terms of taxable years beginning or ending with reference to a specified date which is the first or last day of a month, with respect to a corporation which has elected to make a return to the federal government on the basis of an annual period which varies from fifty-two to fifty-three weeks, its taxable year shall be treated as beginning with the first day of the calendar month beginning nearest to the first day of such taxable year, or as ending with the last day of the calendar month ending nearest to the last day of such taxable year.

13. "State", any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or a political subdivision of any of the foregoing.

14. "DISC", a corporation which meets the requirements of section 992(a)(1) of the Federal Internal Revenue Code, as amended and in effect for the taxable year.

15. "Wholly-owned DISC", a DISC all of whose outstanding shares, except directors' qualifying shares, are owned by a single corporation, either directly or indirectly

through other corporations all of whose shares are owned directly or indirectly by such corporation.

APPENDIX F

MASS. REGS. CODE tit. 830, § 63.30.2 NET OPERATING LOSS DEDUCTIONS AND CARRYOVER

(1) *Statement of Purpose, Outline of Topics.* (a) *Purpose of Regulation.* 830 CMR 63.30.2, explains how, and to what extent, a corporation may apply the deductions for net operating losses incurred in previous taxable years allowed by M.G.L. c. 63, §30.5, *as amended by* St. 1992, c. 133, §§402 and 403, and St. 1988, c. 202, §10, in determining net income for a taxable year. 830 CMR 63.30.2 applies only to the corporate excise imposed by M.G.L. c. 63.

(b) *Outline of Topics.* In order to facilitate the use of 830 CMR 63.30.2, 830 CMR 63.30.2(1)(b) lists the sections contained in 830 CMR 63.30.2.

1. Statement of Purpose. Outline of Topics.
2. Definitions.
3. Allowance of Net Operating Loss Deduction.
4. Computation of Net Operating Loss.
5. Start-up Corporation Net Operating Loss Deduction.
6. General Net Operating Loss Deduction.
7. Carryover of Net Operating Loss.
8. Examples.
9. S Corporations.
10. Combined Groups.

11. Mergers and Changes of Ownership.

12. Supporting Schedule Required.

(*As added January* 1, 1993.)

(2) *Definitions.* For purposes of 830 CMR 63.30.2, the following terms shall have the following meanings, unless the context requires otherwise.

Code, the Internal Revenue Code, as amended and in effect for the taxable year.

Commissioner, the Commissioner of the Massachusetts Department of Revenue or the Commissioner's duly authorized representative.

Corporation, a business corporation organized under or subject to M.G.L. c. 156B, subject to the excise imposed by M.G.L. c. 63, §32 or 32D(b), or a corporation, association, or organization established under laws other than those of Massachusetts, subject to the excise imposed by M.G.L. c. 63, §39 or 32D(b).

Deduction or deductions, the deductions for net operating losses incurred in previous taxable years allowed by either M.G.L. c. 63, §30.5(b) or M.G.L. c. 63, §30.5(c)

Documentary evidence, original source documents that substantiate a claim for the deduction, including but not limited to articles of incorporation, stock certificates, and tax returns, but generally not including affidavits.

Federal net operating loss, net operating loss computed under Code §172 for purposes of determining the federal net operating loss deduction.

Federal net operating loss deduction, the deduction for net operating loss incurred in previous taxable years allowed by Code §172.

General net operating loss deduction, the deduction for net operating losses incurred in previous taxable years allowed by M.G.L. c. 63, §30.5(b).

Net income for purposes of determining the general net operating loss deduction, net income determined under the provisions of M.G.L. c. 63, §30.4, without regard to the net operating loss deduction allowed by M.G.L. c. 63, §30.5.

Net income, net income determined under M.G.L. c. 63, §30.4, for purposes of computing the income measure of the corporate excise.

Net operating loss, the amount by which the sum of the deductions allowed under M.G.L. c. 63, §30.4, not including the deductions for net operating loss allowed by M.G.L. c. 63, §30.5, and the dividends received deduction allowed by M.G.L. c. 63, s. 38(a)(1), exceeds gross income determined under the provisions of M.G.L. c. 63, §30.3 for taxable year.

Start-up corporation net operating loss deduction, the deduction for net operating losses incurred in previous taxable years allowed by M.G.L. c. 63, §30.5(c).

Taxable year, any fiscal or calendar year or period for which a corporation is required to file a federal income tax return.

Taxable net income, net income less the Massachusetts dividends received deduction allowed by M.G.L. c. 63, §38(a)(1).

(*As added January* 1, 1993.)

(3) *Allowance of Net Operating Loss Deduction.*

(a) *General Rule.* In calculating net income for a taxable year, corporations may claim one of the two following deductions for net operating losses incurred in previous taxable years:

1. *Start-up corporation net operating loss deduction.* During the first five taxable years of its existence, a corporation may deduct losses incurred in previous taxable years, to the extent allowed by M.G.L. c. 63, §30.5(c), and 830 CMR 63.30.2; or

2. *General net operating loss deduction.* A corporation may deduct losses incurred in taxable years ending on or after December 31, 1989, to the extent allowed by M.G.L. c. 63, §30.5(b), and 830 CMR 63.30.2.

(b) *Only One Deduction Available for Each Taxable Year.* A corporation may claim only one of the two net operating loss deductions in any taxable year. Where a corporation qualifies for both deductions in a taxable year, the choice between the two deductions is left to the corporation's discretion.

(c) *Switching Between the Two Deductions Allowed.* A corporation's choice between the two deductions under 830 CMR 63.30.2(3)(b), is effective only for the taxable year for which the deduction is claimed. A corporation may switch between the two deductions from one taxable year to another. Net operating loss incurred in a single taxable year may be split between the two net operating loss deductions claimed in two subsequent taxable years. However, where a corporation switches from the start-up corporation net operating loss deduction to the general net

operating loss deduction, the corporation may not deduct or carry over any amounts that were treated as non-deductible losses under the start-up corporation net operating loss restrictions described at 830 CMR 63.30.2(5)(b)2, and (c), to the extent that those restrictions were imposed in a previous taxable year for which the corporation claimed the start-up corporation net operating loss deduction. *See* 830 CMR 63.30.2(7)(c)3.

(d) *Deduction Available Only to Business Corporations.* The deductions are available only in computing net income under M.G.L. c. 63, §30.4, for purposes of computing a corporation's liability under the income measure of the corporate excise. The deductions are not available to any corporation whose liability under the corporate excise is not based on net income as defined under M.G.L. c. 63, §30.4. Specifically, utility corporations subject to tax under M.G.L. c. 63, §52A, and security corporations subject to tax under M.G.L. c. 63, §38B, are among those corporations that may not claim the deductions.

(*As added January* 1, 1993.)

(4) *Computation of Net Operating Loss.*

(a) *General.* A corporation incurs a net operating loss for a taxable year if net income as defined in M.G.L. c. 63, §30.4, for the taxable year, determined without regard to the net operating loss deductions allowed under M.G.L. c. 63, §30.5, and reduced by the dividends received deduction allowed under M.G.L. c. 63, §38(a)(1), is less than zero.

(b) *Computation of Net Operating Loss.* The amount of net operating loss incurred in a taxable year is the amount by which the sum of the deductions allowed for the taxable year under M.G.L. c. 63, §30.4, not including the deductions

for net operating loss allowed by M.G.L. c. 63, §30.5, and the dividends received deduction allowed under M.G.L. c. 63. §38(a)(1), exceeds gross income as defined in M.G.L. c. 63, §30.3, for the taxable year.

(c) *Required Adjustments.* Where any provision of M.G.L. c. 63 requires net income to be adjusted, a corresponding adjustment must be made in computing net operating loss. For example, where M.G.L. c. 63, §38H(b)(1), disallows a deduction under M.G.L. c. 63, §30.4, with respect to expenditures for solar and wind power equipment deducted under M.G.L. c. 63, §38H(a), the disallowed deduction may not be taken into account in determining net operating loss. Other provisions of M.G.L. c. 63 that require adjustments to net operating loss include M.G.L. c. 32E(c), and 38M(b).

(d) *Other Massachusetts Deductions, Adjustments, and Credit Disregarded.* Net operating loss is determined solely with reference to M.G.L. c. 63, §30 and §38(a)(1). Except as provided in 830 CMR 63.30.2(4)(c), any deductions, adjustments, and credits allowed by other provisions of M.G.L. c. 63 are disregarded in determining net operating loss. Specifically, the following items are disregarded:

1. *Post-apportionment deductions.* Net operating loss is computed without regard to the deductions from taxable net income apportioned to Massachusetts that are allowed by M.G.L. c. 63, §§38F and 38H.

2. *Massachusetts credits.* Net operating loss is computed without regard to any of the credits against the corporate excise allowed by M.G.L. c. 63.

(e) *Net Operating Loss Computed Before Apportionment.* Where a corporation does business both within and without

Massachusetts, the corporation's net operating loss is computed before applying the appointment provisions of M.G.L. c. 63, §§38 and 42.

(*As added January* 1, 1993.)

(5) *Start-up Corporation Net Operating Loss Deduction.*

(a) *General.* Corporations that meet the eligibility requirements of 830 CMR 63.30.2(5)(b), may deduct net operating losses, as computed under 830 CMR 63.30.2(4), incurred in previous taxable years ending on or after December 31, 1975. The portion of the start-up corporation net operating loss deduction that is not used in a taxable year may be carried forward to succeeding taxable years, subject to the limitations described at 830 CMR 63.30.2(5)(c), and (7).

(b) Eligibility for the Deduction. To claim the start-up corporation net operating loss deduction for a taxable year, a corporation must meet all of the following requirements at all times during the taxable year.

1. *First Five Years.* The corporation must be in one of its first five consecutive taxable years of existence, measured from the earliest date of the corporation's establishment, organization, incorporation, or charter, whether the corporation was established, organized, incorporated, or chartered under the laws of Massachusetts or another jurisdiction; and

2. *Ownership of Voting Stock.* No other corporation, whether or not taxable in Massachusetts, may own 50% or more of the voting stock of the corporation.

(c) *Restrictions on the Deduction.* The following items of loss do not qualify for the start-up corporation net operating loss deduction:

1. *Certain losses incurred by foreign corporations.* Net operating losses incurred by a foreign corporation in previous taxable years during which the corporation was not subject to the Massachusetts corporate excise are not treated as net operating losses for purposes of determining the start-up corporation net operating loss deduction; and

2. *Net operating losses carried back for federal net operating loss purposes.* The start-up corporation net operating loss deduction is not available for any portion of the net operating loss incurred in a taxable year that is carried back to a previous taxable year for purposes of determining the federal net operating loss deduction.

(d) *Computation of the Start-up Corporation Net Operating Loss Deduction.* The amount of the start-up corporation net operating loss deduction for a taxable year is the sum of the net operating losses available for carryover from each of the corporation's four previous taxable years, as determined under 830 CMR 63.30.2(7)(c) and (d). The amount of net operating loss available for carryover from a previous taxable year is the net operating loss for the taxable year as determined under 830 CMR 63.30.2(4), not including losses incurred by foreign corporations in taxable years during which they are not subject to the corporate excise, reduced by the amount of the net operating loss previously deducted, as required by 830 CMR 63.30.2(7)(c)4, and further reduced by the amount of the net operating loss carried back to previous taxable years for federal net operating loss purposes, as required by 830 CMR 63.30.2(7)(c)2.

1. *Net operating losses previously deducted.* The amount of net operating losses previously deducted is the amount of net operating loss incurred in a taxable year that already has been deducted under the provisions of M.G.L. c. 63, §30.5, and 830 CMR 63.30.2, in taxable years beginning after the taxable year in which the loss occurred and before the taxable year for which the deduction is being computed. *See* 830 CMR 63.30.2(7)(c)4.

2. *Net operating losses carried back for federal purposes.* The amount of net operating loss carried back for federal net operating loss purposes is the amount of net operating loss incurred in a taxable year that was carried back to taxable years beginning before the year of the loss under Code §172(b)(1)(A)(i), for purposes of computing the federal net operating loss deduction. *See* 830 CMR 63.30.2(7)(c)2.

(e) *Evidence.* Any corporation that claims the start-up corporation net operating loss deduction must upon request furnish to the Commissioner documentary evidence as defined at 830 CMR 63.30.2(2), to substantiate the claim.

(*As added by January* 1, 1993.)

(6) *General Net Operating Loss Deduction.*

(a) *General.* A corporation that does not claim the start-up corporation net operating loss deduction described at 830 CMR 63.30.2(5), may claim the general net operating loss deduction with respect to net operating losses, as computed under 830 CMR 63.30.2(4), incurred in previous taxable years ending on or after December 31, 1989. The amount of the general net operating loss deduction for a taxable year shall not exceed the limitations imposed by

M.G.L. c. 63, §30.5(b)(1)-(4), as set forth at 830 CMR 63.30.2(6)(b). The amount of net operating loss that is disallowed as a deduction in a taxable year because of those limitations may be carried over to succeeding taxable years under the carryover rules at 830 CMR 63.30.2(7).

(b) *Limitation of the Deduction.* The amount of the general net operating loss deduction may not exceed the following amounts for the following taxable years:

1. For taxable years ending on or after December 31, 1990 and before December 31, 1991, the amount of the deduction may not exceed 25% of the corporation's net income as computed under 830 CMR 63.30.2(6)(c);

2. For taxable years ending on or after December 31, 1991 and before December 31, 1992, the amount of the deduction may not exceed 50% of the corporation's net income as computed under 830 CMR 63.30.2(6)(c);

3. For taxable years ending on or after December 31, 1992 and before December 31, 1993, the amount of the deduction may not exceed 75% of the corporation's net income as computed under 830 CMR 63.30.2(6)(c); and

4. For taxable years ending on or after December 31, 1993, the amount of the deduction may not exceed 100% of the corporation's net income as computed under 830 CMR 63.30.2(6)(c).

The amount of net operating loss disallowed as a deduction for a taxable year because of the foregoing limitations may be carried forward to subsequent taxable years to the extent allowed under the carryover rules of 830 CMR 63.30.2(7).

(c) *Net Income Defined for Purposes of Applying the Limitations on the General Net Operating Loss Deduction.* For purposes of applying the limitations on the amount of the general net operating loss deduction set forth at 830 CMR 63.30.2(6)(b), net income for a taxable year is net income as defined in M.G.L. c. 63, §30.4, determined without regard to the net operating loss deductions allowed under M.G.L. c. 63, §30.5, and before applying the apportionment provisions of M.G.L. c. 63, §§38 and 42. Net income for purposes of applying the limitation is computed solely with reference to M.G.L. c. 63 §30.4, and without regard to the dividends received deduction allowed under M.G.L. c. 63, §38(a)(1), or the items described in 830 CMR 63.30.2(4)(d).

(d) *Computation of the General Net Operating Loss Deduction.* The amount of the general net operating loss deduction for a taxable year is the lesser of the sum of the net operating losses available for carryover from previous taxable years under the provisions of 830 CMR 63.30.2(7), or the maximum amount of the deduction determined under the limitation provisions of 830 CMR 63.30.2(6)(b).

1. *Net operating losses available for carryover.* The amount of net operating loss available for carryover from a previous taxable year is the net operating loss for the taxable year as determined under 830 CMR 63.30.2(4), that may be carried over under the provisions of 830 CMR 63.30.2(7), reduced by the amount of the net operating loss for such taxable year that has been previously deducted.

2. *Net operating losses previously deducted.* The amount of net operating loss previously deducted is the amount of net operating loss incurred in a taxable year that already has been deducted under the provisions of M.G.L. c. 63,

§30.5, in taxable years beginning after the taxable year in which the loss occurred and before the taxable year for which the deduction is being computed. *See* 830 CMR 63.30.2(7)(c)4.

(*As added January* 1, 1993.)

(7) *Carryover of Net Operating Loss.*

(a) *General.* A net operating loss incurred in a taxable year may be carried over to succeeding taxable years as follows.

1. *Start-up corporation net operating loss.* For purposes of determining the start-up corporation net operating loss deduction described at 830 CMR 63.30.2(5), a net operating loss may be carried forward to any succeeding taxable year that ends less than five calendar years after the date on which the corporation was organized.

2. *General net operating loss.* For purposes of determining the general net operating loss deduction described at 830 CMR 63.30.2(6), a net operating loss may be carried forward to the five successful taxable years following the year in which the loss was incurred.

(b) *Ordering Rules.* Net operating loss carryover shall be deducted after all current deductions allowed in determining current taxable net income, including the dividends received deduction allowed by M.G.L. c. 63, §38(a)(1). Net operating loss must be carried over to the earliest succeeding taxable year in which it may be used. The portion of the net operating loss that is not used in the earliest succeeding taxable year within the applicable carryover period set forth at 830 CMR 63.30.2(7)(a).

(c) *Carryover.* The amount of net operating loss incurred in a given taxable year that may be carried over to a succeeding taxable year is determined using the following steps.

1. Compute the net operating loss for the taxable year under the provisions of 830 CMR 63.30.2(4). For purposes of computing the start-up corporation net operating loss, losses incurred by a foreign corporation in a taxable year during which the corporation is not subject to the corporate excise are not treated as net operating losses and are not eligible for the start-up corporation net operating loss deduction. The net operating loss for the taxable year must be determined under the law applicable to the taxable year in which the loss was incurred without regard to the law applicable to the taxable year to which the net operating loss is being carried. The result is the corporation's tentative net operating loss carryover from the taxable year in which the loss was incurred.

2. In determining the carryover amount for start-up corporation net operating loss purposes only, subtract from the tentative net operating loss carryover, as determined under 830 CMR 63.30.3(7)(c)1., the amount of such net operating loss that was carried back to taxable years preceding the year of the loss for federal net operating loss purposes under Code §172(b)(1)(A)(i). In determining the carryover amount for general net operating loss purposes, skip this step and go directly to step 3.

3. In determining the carryover amount for general net operating loss purposes only, subtract from the tentative net operating carryover, as determined under 830 CMR 63.30.3(7)(c)1, the following amounts:

a. The amount of such net operating loss that was carried back for federal purposes and was therefore treated as a non-deductible loss under the restrictions described at 830 CMR 63.30.2(5)(c)2, (5)(d)2, and (7)(c)2., in any taxable year for which the corporation claimed the start-up corporation net operating loss deduction; and

b. The amount of such net operating loss that was incurred in a taxable year during which the corporation was a foreign corporation not subject to the corporate excise and that was treated as a non-deductible loss under the restrictions described at 830 CMR 63.30.2(5)(c)1, in any taxable year for which the corporation claimed the start-up corporation net operating loss deduction; and

c. The amount of such net operating loss that was treated as a non-deductible loss because of the restrictions placed on the deduction by subsidiaries under 830 CMR 63.30.2(5)(b)2., in any taxable year during which the corporation claimed the start-up corporation net operating loss deduction.

In determining the carryover amount for start-up corporation net operating loss purposes, skip this step and go directly to step 4.

4. Subtract from the tentative net operating loss carryover, as determined under 830 CMR 63.30.3(7)(c)1., the amount of such net operating loss that was deducted under the provisions of M.G.L. c. 63, §30.5, in taxable years beginning after the taxable year in which the loss was incurred. The result is the amount of the net operating loss incurred in the taxable year that is available for carryover.

(d) *Amount of Net Operating Loss Available for Carryover.* The amount of the net operating loss that is available for carryover to a taxable year is the sum of the net operating loss available for carryover from previous taxable years, determined under 830 CMR 63.30.2(7)(c)1.-4., that may be carried over under the applicable limitations set forth at 830 CMR 63.30.2(7)(a).

(e) *Unused Net Operating Loss.* Net operating loss incurred in a taxable year that is not deducted within the period set forth at 830 CMR 63.30.2(7)(a), is lost and may not be deducted for Massachusetts corporate excise purposes.

(f) *Short Taxable Years.* A taxable year that consists of less than 12 months is treated as a full taxable year for purposes of 830 CMR 63.30.2.

(g) *Foreign Corporations Not Subject to Tax.*

1. *General.* Taxable years during which a foreign corporation is not subject to the Massachusetts corporate excise are treated as taxable years for purposes of 830 CMR 63.30.2.

2. *Imported Losses.* For purposes of claiming the general net operating loss deduction only, foreign corporations may carry over and deduct net operating losses, calculated under the provisions of 830 CMR 63.30.2, that were incurred in taxable years during which the foreign corporation was not subject to the corporate excise. To claim the deduction with respect to such losses, the foreign corporation must complete a pro forma Massachusetts Schedule E showing the computation of Massachusetts net operating loss, Massachusetts net income and Massachusetts taxable net income for each such taxable year. Such pro forma

schedules must be attached to the return for the taxable year for which the deduction is claimed.

3. *Loss Carry Through.* Net operating loss may be carried through taxable years during which the foreign corporation is not subject to the corporate excise. However, where the corporation has positive taxable net income determined without regard to the net operating loss deduction in any such taxable year, the amount of net operating loss that may be carried through that year must be reduced by the amount of such taxable net income. A corporation that claims the deduction with respect to any net operating loss carried through taxable years during which the corporation is not subject to the corporate excise must provide a supporting schedule that fully documents the amount of the deduction and the manner in which the deduction was computed. The corporation need not file a corporate excise return for taxable years during which it is not subject to the corporate excise in order to preserve the net operating loss carryover.

(*As added January* 1, 1993.)

(8) *Examples.* The following examples illustrate the provisions of 830 CMR 63.30.2(1)-(7). For purposes of these examples assume that all of the corporations are calendar year taxpayers that file separate returns. Further assume that none of the corporations claims a Massachusetts dividends received deduction. The corporations do not carry any net operating loss back to previous taxable years for federal tax purposes unless specified in the example.

Example 1: Alpha Centauri, Inc., a Massachusetts business corporation, is organized and begins doing business exclusively in Massachusetts in 1989. All of

Alpha Centauri's stock is owned by individuals. In 1989 Alpha Centauri incurs a net operating loss of $100,000. In 1990 Alpha Centauri has net income of $50,000, determined without regard to the net operating loss deduction.

Because Alpha Centauri is in its first five taxable years of existence and no other corporation owns fifty percent or more of its voting stock, Alpha Centauri is eligible for the start-up corporation net operating loss deduction for 1990. Alternatively, as a business corporation, Alpha Centauri may claim the general net operating loss deduction. Alpha Centauri may deduct either of the following amounts in determining 1990 net income:

A start-up corporation net operating loss deduction of $50,000, resulting in net income of $0 for 1990 and $50,000 of net operating loss available for carryover, or

A general net operating loss deduction of $12,500, computed by multiplying net income of $50,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for 1990 (25%). The general net operating loss deduction results in net income of $38,500 and $87,500 of net operating loss available for carryover.

Example 2: Assume that in Example 1 Alpha Centauri elects to take the start-up corporation net operating loss deduction. In 1991, Alpha Centauri has net income of $80,000 determined without regard to the net operating loss deduction. Alpha Centauri once again is eligible for both deductions, and may deduct either of the following amounts in determining 1991 net income:

A start-up corporation net operating loss deduction of $50,000 (the amount of net operating loss available for

carryover from 1990), resulting in net income of $30,000, and no net operating loss available for carryover, or

A general net operating loss deduction of $40,000, computed by multiplying net income of $80,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for 1991 (50%). The general net operating loss deduction results in net income of $40,000, and net operating loss available for carryover of $10,000, computed by subtracting the 1991 general net operating loss deduction of $40,000, from the $50,000 of net operating loss Alpha Centauri has available for carryover after claiming the start-up corporation net operating loss deduction in 1990.

Example 3: Betelgeuse, Inc. is a foreign corporation that has been in existence for ten years. In 1989 Betelgeuse does not do business in Massachusetts, but incurs a loss for the year. In 1990 Betelgeuse does business in Massachusetts and incurs a net operating loss of $40,000. In 1991, Betelgeuse does business in Massachusetts and has net income of $100,000, determined without regard to the net operating loss deduction. Betelgeuse's Massachusetts apportionment percentage is 10% for 1990 and 25% for 1991. Betelgeuse may claim the general net operating loss deduction for losses incurred in 1989 and 1990 when computing net income for 1991. The deduction is computed as follows:

To determine the amount of net operating loss available for carryover from 1989, Betelgeuse must compute Massachusetts net operating loss under the provisions of 830 CMR 63.30.2(4) in the same manner as if Betelgeuse were doing business in Massachusetts for that taxable year. Assume for the purposes of this example that Betelgeuse's

net operating loss for 1989, determined in that manner, is $20,000. The amount of net operating loss available for carryover from 1990 is $40,000. The total amount of net operating loss available for deduction in 1991 is $60,000.

The maximum allowable amount of Betelgeuse's general net operating loss deduction for 1991 is $50,000, computed by multiplying net income of $100,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for 1991 (50%).

Betelgeuse's net operating loss deduction for the taxable year is $50,000, the lesser of the $60,000 of net operating loss available for deduction for the $50,000 maximum deduction. Betelgeuse has net income of $50,000, computed by subtracting the $50,000 net operating loss deduction from $100,000 of net income, determined without regard to the net operating loss deduction. Betelgeuse's apportioned net income for 1991 is $12,500, determined by multiplying net income of $50,000 by Betelgeuse's apportionment percentage of 25%. Betelgeuse has $10,000 of net operating loss available for carryover. The entire $10,000 is attributable to 1990 net operating loss.

Example 4: Assume the same facts as in Example 4 and that Betelgeuse discontinues doing business in Massachusetts from 1992 through 1994. Betelgeuse has positive taxable net income (determined without regard to the net operating loss deduction) of $500 in 1992, $300 in 1993, and $200 in 1994. In 1995, Betelgeuse resumes doing business in Massachusetts and has net income of $8,000, determined without regard to the net operating loss deduction. Betelgeuse's Massachusetts apportionment

percentage for 1995 is 20%. Betelgeuse may claim the general net operating loss deduction for losses incurred in 1990 when computing 1995 net income.

The amount available for carryover from 1990 is $9,000, determined by subtracting from $40,000 net operating loss incurred in that year, the $30,000 of that loss that was deducted in 1991, and offsetting the resulting amount by the $1,000 of positive taxable net income earned between 1992 and 1994.

The maximum allowable amount of Betelgeuse's general net operating loss deduction for 1995 is $8,000, computed by multiplying net income of $8,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for the taxable year (100%).

Betelgeuse's net operating loss deduction for the taxable year is $8,000 resulting in net income of $0, determined by subtracting the $8,000 net operating loss deduction from $8,000 of net income, determined without regard to the net operating loss deduction.

Betelgeuse has $1,000 of net operating loss attributable to 1990. Because losses may be carried forward only five taxable years from the year in which they are incurred, including taxable years during which a corporation does not do business in Massachusetts, the $1,000 of net operating loss is not available for carryover to subsequent taxable years.

Example 5: Cassiopeia Corporation is a Massachusetts business corporation that organizes and begins doing business in Massachusetts in 1988. In 1988, Cassiopeia has positive net income. In 1989, Cassiopeia incurs a net

operating loss of $40,000. Cassiopeia carries $10,000 of the loss *back* to 1988 to reduce its 1988 income for federal tax purposes. The carry back of net operating loss is not permitted for Massachusetts purposes. Thus, for Massachusetts purposes Cassiopeia's 1988 net income is unaffected by its 1989 net operating loss. Cassiopeia has $40,000 of 1989 net operating loss available for carryover for Massachusetts purposes.

In 1990 Cassiopeia has net income of $20,000, determined without regard to the net operating loss deduction. In order to maximize the amount its 1990 deduction. Cassiopeia chooses the start-up corporation net operating loss deduction for 1990. The amount of net operating loss available to Cassiopeia for purposes of the start-up corporation deduction is $30,000, determined by subtracting from the $40,000 of loss available for carryover from 1989, the $10,000 of loss that was carried back to 1988 for federal tax purposes. (Had Cassiopeia elected to carry the 1989 net operating loss *forward* for federal tax purposes, the full amount of 1989 loss would have been available for carryover for Massachusetts purposes.) The amount of the start-up corporation net operating loss deduction is $20,000, resulting in net income of $0 and $10,000 of 1989 net operating loss available for carryover.

Had Cassiopeia chosen the general net operating loss deduction for 1990, the amount of the deduction would have been $5,000, computed by multiplying net income of $20,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction (25%). Neither the 1990 general net operating loss deduction nor the amount of loss available for carryover from 1989 would be affected by the $10,000 of 1989 loss carried back for federal purposes. The general

net operating loss would have resulted in net income of $15,000, and $35,000 of 1989 net operating loss available for carryover.

Example 6: Assume the same facts as in Example 5, and that Neutron Star, LTD, a Massachusetts corporation, acquires 50 percent of Cassiopeia's voting stock in 1991. Because another corporation owns fifty percent or more of Cassiopeia's voting stock, Cassiopeia is not eligible for the start-up corporation net operating loss deduction for 1991.

In 1991, Cassiopeia has net income of $12,000, determined without regard to the net operating loss deduction. Cassiopeia may claim a general net operating loss deduction of $6,000, determined by adding the amounts of net operating loss available for carryover from previous taxable years and applying the applicable limitation to the deduction as follows:

The amount of net operating loss available for carryover from 1989 is $10,000 determined by subtracting from the $40,000 net operating loss incurred in that year, the $20,000 of that loss that was deducted in 1990, and the 10,000 of that loss that was carried back for federal tax purposes. Even though Cassiopeia is claiming the general net operating loss deduction for 1991, the $10,000 treated as non-deductible in 1989 is eliminated from the pool of loss available for carryover under the restrictions described at 830 CMR 63.30.2(5)(c).

The maximum allowable deduction is $6,000, computed by multiplying Cassiopeia's net income of $12,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for 1990 (50%). Cassiopeia's 1991 net operating loss

deduction is $6,000, resulting in net income of $6,000 and $4,000 of 1989 net operating loss available for carryover.

Example 7: Dog Star, Inc. is a foreign corporation that begins doing business in Massachusetts to 1992. To compute its net operating loss available for carryover to 1992, Dog Star must determine its net operating loss, net income, and taxable net income for taxable years 1989 through 1991 as though it were doing business in Massachusetts. Dog Star applies the provisions of M.G.L. c. 63, and 830 CMR 63.30.2, to those taxable years and determines that in 1989 and 1990 it incurred net operating losses of $15,000, and $10,000, respectively. In 1991 it has positive taxable net income of $12,000, determined without regard to the net operating loss deduction. Dog Star's total net operating loss available for carryover to 1992 is $13,000, determined by adding the 1990 net operating loss of $15,000 and the 1990 net operating loss of $10,000, and subtracting 1991 taxable net income of $12,000. Of the total net operating loss available for carryover to 1992, $3,000 is attributable to 1989, and $10,000 is attributable to 1990. Because the losses available for carryover to 1992 were incurred in taxable years during which Dog Star was not subject to the corporate excise, Dog Star may deduct those losses only if it chooses the general net operating loss deduction.

(*As added January* 1, 1993.)

(9) *S Corporations.*

(a) *General.* A Massachusetts S corporation that is subject to the income measure of the corporate excise due to total receipts of six million dollars or more may claim a net operating loss deduction for net operating losses incurred in taxable years ending on or after December 31,

1989, as provided below. The deduction is available only in computing net income for purposes of determining the income measure of the corporate excise under M.G.L. c. 63, §32D(b), and only to the extent that it would be allowed to a C corporation under the provisions M.G.L. c. 63, §30.5, and 830 CMR 63.30.2. A Massachusetts S corporation may not deduct any net operating losses incurred in taxable years ending before December 31, 1989.

(b) *Generation of Net Operating Loss.* An S corporation can incur a net operating loss only in a taxable year during which it is subject to the income measure of the corporate excise due to total receipts of six million dollars or more. Losses incurred in taxable years during which the S corporation had total receipts of less than six million dollars are not net operating losses for purposes of M.G.L. c. 63, s. 30.5, and 830 CMR 63.30.2.

(c) *Carryover of S Corporation Losses.* Subject to the carryover provisions of 830 CMR 63.30.2(7), an S corporation may carry a net operating loss through succeeding taxable years during which the S corporation has total receipts of less than six million dollars, and may deduct the loss in succeeding taxable years during which the corporation has total receipts of six million dollars or more. For purposes of applying the carryover provisions of 830 CMR 63.30.2(7), taxable years during which the S corporation has total receipts of less than six million dollars and short taxable years are treated as full taxable years.

(d) *Deduction Restricted.* A Massachusetts S corporation that receives income taxed to the S corporation for federal purposes may not deduct net operating losses from that

income for purposes of computing its tax liability under M.G.L. c. 63, §32D(a).

(*As amended January* 1, 1993.)

(10) *Combined Groups.* The net operating loss deduction and carryover amounts are computed separately, under the provisions of 830 CMR 63.30.2, for each corporation that is a member of a combined group, as defined at 830 CMR 63.32B.1(2). The combined group itself, therefore, has no net operating loss deduction or carryover. Net operating loss carried over by a member of the group may be used to reduce the combined net income of the group only under the circumstances and in the manner described in the net operating loss carryover provisions of the combined returns of income regulation at 830 CMR 63.32B.1(9). A member of a combined group that uses its net operating loss to reduce the combined net income of the group for a taxable year must reduce its net operating loss available for carryover in the manner required by 830 CMR 63.30.2(7)(c). The amount of the required reduction shall be the amount of the member's apportioned loss that was used to reduce the combined income of the group, divided by the member's apportionment percentage for the taxable year.

(*As added by January* 1, 1993.)

(11) *Mergers and Changes of Ownership.*

(a) *Mergers.* In the event of a merger of two or more corporations, the surviving corporation retains any net operating loss that is separately incurred before the merger, subject to the limitations of 830 CMR 63.30.2(11)(b). All of the net operating loss of a corporation absorbed in the merger is lost. The surviving corporation

may not deduct or carry over the net operating loss of a corporation it absorbs. In the event of a consolidation of two or more previously existing corporations into a new corporation, the new corporation starts with no net operating loss. All of the net operating loss of the previously existing corporations is lost. The new corporation may not deduct or carry over any net operating loss incurred by any of the previously existing corporations before the consolidation.

(b) *Changes in Ownership.* Where a corporation undergoes an ownership change, as defined in Code §382(g), the amount of the corporation's net income that may be offset by pre-change net operating loss in any taxable year shall not exceed the limitation imposed by Code §382, provided that the limitation shall be adjusted for differences between Massachusetts taxable net income and federal taxable income determined without regard to the federal net operating loss deduction. The adjustment shall be made for each taxable year by multiplying the Code §382 limitation by Massachusetts taxable net income, determined without regard to the net operating loss deduction, and dividing the resulting amount by federal taxable income, determined without regard to the federal net operating loss deduction. Any amount of net operating loss that cannot be deducted because of the limitation may be carried over as provided in 830 CMR 63.30.2(7).

(*As added January* 1, 1993.)

(12) *Supporting Schedule Required.* To claim a net operating loss deduction for a taxable year a corporation must file with its tax return a Massachusetts Schedule E-2. The Commissioner may require corporations to attach to Schedule E-2 such additional information and schedules

as the Commissioner determines are necessary for the administration of the deduction. The Commissioner will prescribe the form and content of any additional information and schedules in the instructions to Schedule E-2 and in other public written statements.

APPENDIX G

[LOGO] COMMONWEALTH OF MASSACHUSETTS
Department of Revenue

Letter Ruling 95-4

March 31, 1995

Issue

You request a ruling on behalf of "MassCorp," addressing the issue of whether Massachusetts net operating loss carryover survives a statutory merger that also qualifies as an F reorganization.

Facts

MassCorp is incorporated under the laws of the Commonwealth of Massachusetts and has its principal offices located in Massachusetts. MassCorp is engaged primarily in the research and development, manufacturing and marketing of medical diagnostic products using a proprietary biosensor technology.

MassCorp is currently considering changing its state of incorporation from Massachusetts to Delaware. The reorganization will be effected as follows: 1) MassCorp will form a new corporation under the laws of the state of Delaware ("DelCorp"); 2) each share of the outstanding stock of MassCorp will be converted into an equivalent share of stock of DelCorp. Following the conversion, MassCorp will terminate its corporate existence. It is intended that the conversion will qualify for federal purposes as a tax free reorganization under I.R.C. § 368(a)(1)(F) (1986 as amended) (hereinafter an "F" reorganization).

Subsequent to such reincorporation, DelCorp will continue the identical business carried on by MassCorp prior to the change in its state of incorporation and will have the identical shareholder group that MassCorp had prior to such change. The only difference in the activities, operations and corporate structure of DelCorp will be its state of incorporation.

MassCorp wishes to reincorporate in another state for valid business reasons and not to achieve any state or federal tax savings. Subsequent to such reincorporation, MassCorp will continue to operate its corporate headquarters and manufacturing facility in Massachusetts, and as such, will continue to file a Massachusetts corporate excise tax return. Since the time of its incorporation, MassCorp's operational activities have generated losses. As of its most recent tax year, MassCorp had approximately 50 million dollars of net operating loss available for carryforward.

Discussion of Law

The Massachusetts net operating loss was enacted in 1973 and was available to new corporations in their first five years of business. G.L. c. 63, § 30.5(b). In 1989, the Massachusetts net operating loss was made available to all corporations, not just new corporations, subject to certain phase-in limitations. M.G.L. c. 63, § 30.5(b)&(c), permits carryover of Massachusetts net operating losses subject to certain restrictions and limitations. The Net Operating Loss Deductions and Carryover Regulation, 830 CMR 63.30.2(11), limits net operating loss carryover where there is a merger of two or more corporations. However, the regulation does not provide rules for statutory mergers involving only one corporation.

To determine whether net operating loss carryover survives a statutory merger that qualifies as an F reorganization, we look to the purpose behind carryover provisions. Carryover provisions allow a departure from the general system of a strict annual accounting to bring stability to the tax burden of a business with fluctuating years of profit and loss. *Newmarket Manufacturing, Co. v. United States*, 233 F.2d 493, 496 (1956) citing H.R. Rep. No. 855, 67th Cong., 1st Sess. 9-10 (1939). Restricting the use of net operating loss carryover to the taxpaying entity that incurred the loss is a formalistic approach that has been criticized and abandoned at the federal level. *See generally Libson Shops, Inc. v. Koehler*, 353 U.S. 382 (1957). "The transferee in a statutory merger should be deemed to be continuing in itself the corporate life of the now-defunct component. It follows from this conceptual identity that the two corporate entities are to be treated for a substantive purpose in the income tax as the same taxpayer." *Newmarket*, 233 F.2d at 498. These concepts are now expressly incorporated in the Internal Revenue Code, which provides that an F reorganization, defined as a mere change in identity, form or place of organization, of one corporation,[1] will not cause a corporation to lose its net operating loss carryover. I.R.C. § 381(b).

Although the facts considered in this ruling involve a statutory merger of two corporate entities, one of these corporations will be created solely for purposes of the transaction. After the reincorporation, the identical business carried on by the terminated corporation will

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[1] I.R.C. § 368(a)(1)(F). Revenue Ruling 57-276, 1957-1 C.B. 126, provides that a statutory merger may also qualify as an F reorganization.

continue in the successor. The successor will have the same assets and the identical shareholder group that the terminated corporation had prior to the merger. The only change in the activities, operation and structure of the successor corporation will be its state of incorporation. Thus, there is only one ongoing business enterprise and this single enterprise continues essentially unchanged through the proposed reorganization. The Net Operating Loss Deductions and Carryover Regulation, 830 CMR 63.30.2, limits net operating loss carryover in mergers involving two or more corporations. Net operating loss carryover is not precluded in an F reorganization, which by definition involves only one corporation, even where the F reorganization takes the form of a statutory merger for corporate law purposes.

Conclusion

Massachusetts net operating loss carryover survives a statutory merger if the transaction also qualifies as an F reorganization under I.R.C. § 368(a)(1)(F). The Massachusetts net operating loss carryover will be preserved to the extent that it could have been utilized by the transferor corporation had there been no merger. Accordingly, DelCorp may deduct the net operating loss carryover to the extent it would have been available to MassCorp had there been no merger.

Very truly yours,

/s/ Mitchell Adams
Mitchell Adams
Commissioner of Revenue

APPENDIX H

EXPERT OPINION OF PROFESSOR RICHARD D. POMP[1] MACY'S EAST, INC.

INTRODUCTION

You have contacted me as the former Director of the New York Tax Study Commission and as someone who for nearly 25 years has studied, lectured, taught, published, and consulted with, and testified on behalf of, state governments, regarding issues of state taxation. You have asked me to review from a tax policy perspective the merits of a regulation issued by the Massachusetts Department of Revenue.

That regulation deals with the carryover of net operating losses (NOLs) in the context of a merger. The regulation takes the position that an NOL can only be used by the corporation that incurred it. In other words, if the corporation that incurred an NOL is merged into a newly created corporation that continues the business of the merged corporation, the NOL cannot be used by the newly created corporation that survives the merger.

I conclude that from a tax policy perspective, the regulation embodies a philosophy that has long been rejected at the federal level. Moreover, the regulation is inconsistent with national bankruptcy policy, inconsistent with federal tax policy, and elevates form over substance by disregarding economic reality.

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[1] Adjunct Professor of Law, NYU Law School (LL.M Program in Taxation); Adjunct Professor of Law, Columbia Law School; Alva P. Loiselle Professor of Law, University of Connecticut Law School

Factual Background

This case arises out of the bankruptcies and subsequent reorganization of Macy's and Federated, two corporations involved in the mass merchandising business. In 1990, Federated and certain of its subsidiaries filed for bankruptcy. In 1992, Federated emerged from bankruptcy pursuant to a plan of reorganization, operating seven retail operating subsidiaries, including Jordan Marsh and Abraham & Strauss (A&S). In that same year, Macy's and nine of its directly or indirectly owned subsidiaries, including Macy's South and Macy's Northeast, also filed for bankruptcy.

As part of the restructuring that took place because of their respective bankruptcies, in 1994 Federated and Macy's merged. Macy's was the surviving corporation but subsequently changed its named to Federated Department Stores, Inc. After the merger, a new corporation, Federated Retail Holding, was created. Retail Holding owned the stock in numerous subsidiaries, including A&S and Jordan Marsh.

Another new corporation was also created, Macy's East. Macy's Northeast and Macy's South were merged into Macy's East. Macy's East continues to operate the same business that Macy's Northeast and Macy's South had formerly operated. In addition, operationally Jordan Marsh and A&S became part of Macy's East. One year later, in 1995, Jordan Marsh and A&S were formally merged into Macy's East. With a few exceptions, Jordan Marsh and A&S stores became Macy's stores. (A few A&S stores become Stern's). Macy's East continues to carry on the mass merchandising business previously carried on by

Macy's Northeast, Macy's South, Jordan Marsh, and A&S (hereinafter referred to as the "retail stores").

Prior to their merger with Macy's East, the retail stores had net operating loss carryforwards during their 1991 through 1995 fiscal years. This case raises the question of whether these NOLs can be used by Macy's East, which continues to operate the same business formerly conducted by the merged retail stores.

The Law

The Massachusetts Legislature adopted a statute providing that Massachusetts net operating losses can be claimed as deductions in determining net income (subject to limitations not relevant here).[2] Nothing in the language of the statute restricts the NOLs to those incurred by the person claiming the deduction. "Massachusetts net operating losses . . . shall be allowed as a deduction in determining net income . . . "[3]

Macy's East ("the taxpayer") seeks to offset against its income the NOLs generated by the merged retail stores. According to the taxpayer, its position is consistent with the statute because it is deducting net operating losses in determining net income, which is what the statute allows. According to the taxpayer, the fact that the NOLs were incurred by the merged retail stores and not by Macy's East is irrelevant under the statute.

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[2] G.L c. 63, s. 30.5(b).

[3] Id.

The position of the Department of Revenue is that Macy's East cannot use the NOLs. This position is based on a regulation issued by the Department providing that "[i]n the event of a merger of two or more corporations, the surviving corporation retains any net operating loss that it separately incurred before the merger. . . . All of the net operating loss of the corporation it absorbed in the merger is lost. The surviving corporation may not deduct or carry over the net operating loss of a corporation it absorbs."[4] Because the surviving corporation in the merger between Macy's East and the merged retail stores is Macy's East, which is not the corporation that incurred the losses, the Tax Department contends that a literal interpretation of the regulation prevents the carryover of the NOLs incurred by the merged retail stores. A fair interpretation would be that Macy's East is essentially the same corporation as Macy's Northeast and should be able to use Northeast's losses.

An NOL is the excess of deductions over gross income.[5] The NOL was added to the Internal Revenue Code in 1918. At that time the Code provided for a limited one year carryback and a one year carryforward.[6] During the years at issue in this case, the Internal Revenue Code provided for a 3 year carryback and a 15 year carryforward.[7]

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[4] Regulation 830 CMR 63.30.2(11).

[5] Int. Rev. Code of 1986, Section 172.

[6] 1918 Revenue Act, Ch. 18, Section 204.

[7] In 1997, the carryback period was shortened to 2 years from 3 years and the carryforward period was increased to 20 years from 15 years.

The purpose of an NOL carryback or carryforward is to "ameliorate the unduly drastic consequences of taxing income strictly on an annual basis. [The NOL was] designed to permit a taxpayer to set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year."[8] "Carryover provisions allow a departure from the general system of a strict annual accounting to bring stability to the tax burden of a business with fluctuating years of profit and loss."[9]

OPINION REQUESTED

Whether the Department's literal interpretation of the regulation is invalid as contrary to the statute is an issue for the Appellate Tax Board to resolve. You have asked me to evaluate from a state policy perspective the Department's position. Specifically, you have asked me to evaluate the regulation in the context of national bankruptcy policies and federal tax policies.

Unless there are compelling reasons for doing so, state administrative pronouncements should not thwart national policy objectives. In this case, the position adopted by the Department interferes with the nation's bankruptcy laws, is inconsistent with federal tax policy, and draws a meaningless distinction between economically equivalent transactions. The philosophy reflected by the Department has long been rejected by Congress, the IRS, and the

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[8] Libson Shops, Inc. v. Koehler, 353 U.S. 382, 386, reh.denied, 354 U.S. 943 (1957).

[9] Mass. Letter Ruling 95-4 (citations omitted).

federal judiciary. I am aware of no policy justification for the Department's position.

National Bankruptcy Policy

"The purpose of the Bankruptcy Act is to rehabilitate the debtor in order that the debtor might be motivated to lead a full and productive economic life."[10] In drafting the Bankruptcy Reform Act, Congress had as one of its stated aims an attempt to make tax considerations as nearly neutral as possible in determining whether or not a taxpayer should file a bankruptcy petition.[11]

NOLs are an important asset of a debtor. "Including the right to an NOL carryforward as property of [the] bankruptcy estate furthers the purpose of facilitating the reorganization of [the debtor]."[12]

"Virtually every bankruptcy proceeding involves a federal tax claim or a significant federal tax issue."[13] In order to facilitate the rehabilitation of debtors, the Internal Revenue Code contains numerous favorable provisions for insolvent or bankrupt persons. A small sample follows.

Section 108: Income from Discharge of Indebtedness

Normally, if a taxpayer borrows money there will be no income realized at that time because of the obligation to

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[10] Bostwick v. U.S., 521 F.2d 741, 746 (8th Cir. 1975).

[11] William L. Norton, Jr., 6 Norton Bankruptcy Law and Practice 2d, Section 128:1, citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 274 (1977).

[12] In Re Prudential Lines Inc., Debtor, 928 F.2d 565, 573 (1991).

[13] Frances R. Hill, Toward a Theory of Bankruptcy Tax: A Statutory Coordination Approach, 50 Tax Law. 103 (1996).

repay the loan. If, however, the taxpayer never repays the loan, then income is realized. For example, if a taxpayer borrows $100 but repays only $80 in full discharge of the loan, the taxpayer is enriched by $20 ($100-$80). A major exception to this fundamental principle of taxation is provided for taxpayers whose loans are discharged in bankruptcy. In such a case, no income will be realized. Instead, the taxpayer reduces certain tax attributes. Amounts that are excluded from gross income reduce tax attributes, such as net operating losses (NOLs). Discharge of indebtedness income does not give rise to alternative minimum tax liability.

Section 355: In general, Section 355 defers taxation on the distribution of stock and securities of a controlled corporation. There are exceptions, however, that have the result of taxing a corporation that distributes appreciated property. These exceptions do not apply to distributions made in a Title 11 or similar case.

Section 368: The Bankruptcy Tax Act of 1980 created a new category of reorganization – the G reorganization – for corporations in bankruptcy. Tax attributes carry over under Section 381 to the transferee in a nondivisive G reorganization.

Section 382: Section 382 places a limitation on the amount of income that can be offset by net operating loss (NOL) carryovers. The limitation is called the "Section 382 Limitation." The limitation is triggered by a change in the ownership of a corporation. Section 382 relaxes the rules on what constitutes a change in ownership for Title 11 situations.

Section 422: Section 422 governs the taxation of incentive stock options. A favorable rule is provided for transfers of stock by insolvent individuals.

Section 542: Section 542 defines a personal holding company, which is subject to an onerous tax regime. Excluded from the definition of a personal holding company is a corporation subject to the jurisdiction of the court in a Title 11 or similar case.

There are a number of favorable administrative provisions favoring bankruptcy situations. The commencement of a bankruptcy proceeding operates to stay the issuance of certain assessments. In addition, the IRS moves from a position of being a preferred creditor to that of a general unsecured creditor.

Once the petition for bankruptcy is filed, the IRS must follow the rules of bankruptcy procedure. The bankruptcy court can limit the IRS' ability to enforce its tax obligations in order to produce an agreement that is acceptable to all creditors. Moreover, the bankruptcy court has the power to discharge taxes assessed more than three years before the date of a bankruptcy filing and the authority in Chapter 11 and Chapter 13 situations to place limits on the amount of claims, if such claims would otherwise interfere with a plan of reorganization.

Federal Tax Policy on Reorganizations

The Internal Revenue Code contains numerous provisions that treat reorganizations, such as mergers, as nontaxable events. The underlying assumption of these provisions is that the new corporation is substantially a continuation of the old corporation. "This 'continuity of investment'

principle lies at the heart of the nonrecognition provisions and is the reason why gain or loss, although realized, is not recognized at the time of exchange."[14] The merger of the retail stores, for example, was not a taxable event under the Internal Revenue Code. In a sense, the merger was viewed as just moving assets from one corporate pocket to another. Macy's East was created especially to receive the assets of the retail stores and the other related mass merchandising corporations. The business of the retail stores was continued in the embodiment of Macy's East.

Consistent with the treatment of a reorganization as a nontaxable event is the carryover of tax attributes, such as basis, NOLs, and earnings and profits. Congress has established comprehensive rules to preserve tax attributes "based upon economic realities rather than upon such artificialities as the legal form of the reorganization."[15] These rules do not limit the use of NOLs only to the corporation that generated the loss. To the contrary, under the Internal Revenue Code Macy's East was entitled to use the losses generated by all of the merged retail stores: Macy's Northeast, Macy's South, Jordan Marsh, and A&S.

ANALYSIS

The Department's literal interpretation of the regulation thwarts the national policy of reducing tax obstacles to bankruptcies. By denying Macy's East the use of the NOLs

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[14] Boris I. Bittker and James S. Eustice, Federal Income Taxation of Corporations and Shareholders, p. 14-4 (4th ed. 1979).

[15] S. Rep. No. 1622, 83 Cong., 2d Sess., 52 (1954), reprinted in 1954 U.S. Code Cong. & Admin. News, 4621, 4683.

incurred by the merged retail stores, the Department would increase the tax cost of rehabilitative reorganizations occurring in bankruptcy. Yet the whole thrust of national bankruptcy policy is to eliminate or mitigate the adverse tax consequences that would otherwise result.

The Department's position also interferes with the goal of neutrality by favoring one form of reorganization over another. Had Macy's East been merged into Macy's Northeast, for example,[16] the Department would allow the latter's NOLs to offset the subsequent income. Because the reorganization was accomplished by merging Macy's Northeast into Macy's East, however, the Department argues that the NOLs were extinguished.

The Department would deprive Macy's East, which serves as the continuation of the merged retail stores, of the value of the NOLs, which are an important asset in a bankruptcy. The regulation strips the merged retail stores of the value of their NOLs.

In addition, the Department's treatment of the NOLs is inconsistent with federal tax policy on reorganization, which is otherwise adopted by Massachusetts. Federal law treats the merger of the retail stores into Macy's East as a nontaxable event. No gain or loss is recognized on the merger. Massachusetts law is similar: under State law the merger of the retail stores into Macy's East is also a nontaxable event. Under federal law, the basis that the retail stores had in their assets is inherited by Macy's East. Massachusetts law is similar: under State law Macy's East also inherits the basis that the retail stores

[16] Measured by sales, Macy's Northeast is the largest of the merged retail stores.

had in their assets. Indeed, under federal law all of the tax attributes of the merged retail stores, including their NOLs, are inherited by Macy's East. The one major difference between the Internal Revenue Service's and the Department's position seems to be the treatment of NOLs in the regulation.

One of the informing principles of the national tax treatment of reorganizations is that formal differences in the way a transaction is structured should not lead to different tax results. The Department's position is clearly inconsistent with this principle. To the contrary, the Department's interpretation elevates form over substance. For example, had Macy's East been merged into Macy's Northeast there would be no doubt that the latter's NOL would offset Massachusetts income. The NOLs would then, consistent with the regulation, offset the income of the merged corporation. Moreover, this conclusion would be unaffected even if the merged corporation changed its name to Macy's East.

The emphasis in the regulation on the technical way in which the merger was accomplished flies in the face of national policy: "[I]t would seem a sterile technicality, and wholly unrealistic, to impute to the Congress an intention [under the 1939 Code] to make the loss carry-back dependent upon the mere form in which the reorganization is cast . . ."[17] "[W]hether or not the carry-over is allowed should be based on economic realities rather than upon such artificialities as the legal form of reorganization."[18]

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[17] F.C. Donovan v. U.S., 261 F.2d 470, 475 (1958).

[18] U.S. Cong. And Adm. News, 1954, Vol. 3, p. 4066 (House Report), p. 4683 (Senate Report).

The position taken by the Department that an NOL carryover can only be claimed by the legal entity that incurred it reflects a judicial philosophy that was popular in the early part of the twentieth century with respect to the Internal Revenue Code.[19] This so-called "entity" doctrine was subsequently recognized as being inequitable because it disregarded economic reality.[20] The entity doctrine "did not . . . have a happy history". The doctrine "was not equitable and did not comport with market reality."[21] It "penalized only poorly advised taxpayers and those who for nontax reasons found it necessary to extinguish the loss entity."[22] Accordingly, the entity doctrine has long been rejected at the federal level.[23] Even the

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[19] The Revenue Act of 1924, ch. 234, Section 206(b), 43 Stat. 260, provided that if a "taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding year." This language led the IRS and the courts to focus on the identity of the "taxpayer" that incurred the loss and whether that person was the same as the one that sought to deduct the loss. The IRS' position that the loss could only be used by the same corporation that incurred the loss was upheld in New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934).

[20] See Alprosa Watch Corp., 11 T.C. 240 (1948); Comment, Net Operating Loss Carryovers and Corporate Adjustments, 69 Yale L.J. 1201, 1209-11.

[21] Fieldcrest Mills, Inc. v. Secretary of Revenue, 290 N.C. 586, 592.

[22] Note, Net Operating Loss Carryovers and Corporate Adjustments: Retaining an Advantageous Tax History under Libson Shops and Section 269, 381, and 382, 69 Yale L.J. 1201, 1211 (1960).

[23] "It cannot be said that this tax scheme allows NOL carryovers to be claimed only by the legal entity that generated the loss as the New Colonial Ice Court said of the 1921 Revenue Act." In re Luster, 134 B.R. 632, 637 (1991). "[T]he 1954 Code provision of Section 381 . . . clearly rejects the New Colonial Ice Doctrine." Boris I. Bittker and James S. Eustice, Federal Income Taxation of Corporations and Shareholders, p. 16-87 n. 217.

Department concedes that "[r]estricting the use of net operating loss carryover to the taxpaying entity that incurred the loss is a formalistic approach that has been criticized and abandoned at the federal level."[24]

The Internal Revenue Code of 1954 repudiated the entity doctrine insofar as it had been applied to bar transfer of loss carryovers in certain corporate reorganizations.[25] Even before the formal abandonment of the entity doctrine in 1954, however, both the federal courts and the IRS had abandoned the doctrine in interpreting the 1939 Code.[26] "[T]he entity theory has been repeatedly condemned as unduly formalistic [and] oblivious to business reality, and as frustrating the legislative will."[27]

The modern approach is focusing on economic realities, rather than focusing on the legal identity of the surviving entity. In the merger between Macy's East and the retail stores, the reality is that Macy's East was created to carry on the business of the retail stores. The continuity of the business conducted by Macy's East is more significant under modern thinking than is the continuity – or lack thereof – of the legal entity incurring the NOLs. "The transferee in a statutory merger should be deemed to be continuing in itself the corporate life of the now-defunct component. It follows from this conceptual identity that the two corporate entities are to be treated for a substantive

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[24] Massachusetts Letter Ruling 95-4 (citation omitted) (attached).

[25] Internal Revenue Code of 1954, Section 381.

[26] The history is recited in Thermatool Corporation v. Department of Revenue Services, 651 A.2d 763 (1994).

[27] Id. at 770.

purpose in the income tax as the same taxpayer."[28] In other words, the Internal Revenue Code has long abandoned a mechanical approach that looks to the identity of the surviving corporation, which is the approach in the regulation, and instead looks to the substance of the merged corporations.

During the formative days of the Internal Revenue Code, the Department's position might have been defended as an attempt to deal with possible tax avoidance situations, such as the trafficking in tax losses. For example, it was once common for a high-profit corporation to acquire cheaply a corporation with huge NOLs; the loss corporation would be merged into the profitable corporation with the primary purpose being tax avoidance. Today, however, the Internal Revenue Code contains numerous anti-tax avoidance provisions, both general as well as specific to the carryover of tax attributes, which address the trafficking in tax losses.[29] In any event, this case has nothing to do with tax avoidance or the trafficking in tax losses because Macy's East was created with one purpose – to carry on the mass merchandising business of the retail stores. From the day it was formed, Macy's East carried on – and continues to carry on – that business. Because of the efficiencies achieved from the reorganization, that business is now profitable. The Department is more than willing to tax

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[28] Newmarket Manufacturing Co. v. U.S., 233 F.2d 493, 498, cited in Letter Ruling 95-4, 1995 Mass. Tax Lexis 24.

[29] See e.g., IRC Section 269, Section 382(a). Section 382 has been described as a response to the trafficking in operating loss carryover. Maxwell Hardware Co. v. Comm'r, 343 F.2d 713, 718-19 (9th Cir. 1965).

these profits while ignoring the losses that should also be viewed as part of the business.[30]

Massachusetts law should be interpreted in a manner that advances sound principles of bankruptcy and tax policy. As interpreted by the Department, the regulation would thwart these principles. However, there is a way of interpreting the regulation as applied to Macy's East under the facts of this case that would further these principles. The regulation provides that "[i]n the event of a merger of two or more corporations, the surviving corporation retains any net operating loss that it separately incurred before the merger . . ." Under the facts of this case, Macy's East is the embodiment and continuation of the merged retail stores. Accordingly, it would be consistent with the principles of bankruptcy and tax policy to treat Macy's East as if it were substantially identical to the merged retail stores so that those stores could be viewed as if they had actually survived the merger. At the very least, it should be treated as the continuation of Macy's Northeast.

Indeed, the Department has already shown this type of policy-oriented interpretation of the regulation in the case of a Massachusetts corporation changing its state of incorporation from Massachusetts to Delaware, which

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[30] The unfairness is highlighted by the fact that the Massachusetts stores lost money both prior to, and during, the years at issue. The profits that the Department seeks to tax were earned in New York and New Jersey by the stores previously owned by Macy's Northeast, as well as in the southeastern states by the stores previously owned by Macy's Southeast. The Department refuses to allow the losses generated by those stores to offset the income such stores subsequently earned and which the Department now seeks to tax.

involved the "statutory merger of two corporate entities."[31] The Massachusetts corporation had $50 million of NOL carryforwards, which under the Department's literal interpretation of the regulation would not survive the merger because the Massachusetts corporation did not survive the merger. Nonetheless, the Department ruled that the NOLs of the Massachusetts corporation could be deducted by the Delaware corporation, which was the survivor. In reaching this sensible conclusion, the Department emphasized that although there was a "merger of two corporate entities, one of these corporations will be created solely for purposes of the transaction. After the reincorporation, the identical business carried on by the terminated corporation will continue in the successor."[32] "[T]here is only one ongoing business enterprise and this single enterprise continues essentially unchanged through the proposed reorganization."[33]

This same pragmatic interpretation of the regulation should be applied to the case at hand. Macy's East was created solely for the purpose of the merger. After the merger, the identical business formerly carried on by the retail stores was now continued in Macy's East. There is only one ongoing business which is continued by Macy's East, which was created solely to carry on the business of the merged corporations. The same policy considerations that influenced the Department's approach in the case of a reincorporation should also be applied to Macy's East.

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[31] Massachusetts Ruling 95-4.

[32] Id.

[33] Id.

CONCLUSION

With the exception of the Department's interpretation of the regulation, Massachusetts law generally conforms with federal tax law on reorganizations. Unfortunately, the Department's position is inconsistent with federal bankruptcy law and federal tax law. That position: 1) interferes with national bankruptcy policy by imposing a tax cost on the rehabilitation of corporations; 2) deviates from the Internal Revenue Code's longstanding treatment of mergers and reorganizations; and 3) elevates form over substance. The position in the regulation adopts a philosophy that has long been abandoned at the federal level. "[The approach in the regulations] has been weighed in the balances of the federal judiciary and found wanting. It can be justified only by sterile technicalities that a host of federal judges and distinguished commentators have well-nigh universally rejected."[34] From a policy perspective, the Department's approach cannot be justified. The regulation should be interpreted under the facts of this case as if the merged retail stores were the survivors in the merger. Interpreted in this manner, the regulation would advance and not undercut sound policy.

I am aware of no policy justification in favor of limiting the use of NOLs as advocated by the Department. The statute does not prevent the use of the NOLs incurred by the merged retail stores and I find no principled policy considerations in favor of the Department's interpretation of the regulation.

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[34] Supra note 26, at 770.

APPENDIX I

April 27, 2001

Macy's East, Inc.
Expert Report
Net Operating Loss Utilization in Massachusetts

Report prepared by: Richard W. Genetelli
The Genetelli Consulting Group

This report analyzes financial data of Macy's East, Inc. for the tax year ended February 1, 1997. The report is based on facts set forth in the Petition of Macy's East, Inc., filed with the Massachusetts Appellate Tax Board on December 18, 1998, the Amended Petition of Macy's East, Inc., filed with the Massachusetts Appellate Tax Board on November 2, 1999, the Second Amended Petition of Macy's East, Inc., filed with the Massachusetts Appellate Tax Board on July 20, 2000, the first, second and third amended Massachusetts Corporation Excise Tax returns of Macy's East, Inc. for the tax year ended February 1, 1997, and additional facts as referenced below.

The report states my opinion regarding the proper tax accounting for the utilization of net operating loss carryover by Macy's East, Inc. in Massachusetts for the tax year ended February 1, 1997 attributable to the activities of Jordan Marsh Stores Corporation ("Jordan Marsh"), Abraham & Straus, Inc. ("A&S"), Macy's Northeast, Inc. and Macy's South, Inc. for reporting periods prior to the merger of those corporations into Macy's East, Inc.

As set forth below, and based on my experience as an accountant, it is my opinion that, under general principles of accounting and finance, the Massachusetts net operating loss utilization by Macy's East, Inc. for the tax year ended February 1, 1997 should be computed as set forth in

the schedules accompanying this report. The report assumes that pre-merger losses of corporations may be claimed as net operating loss carryover by the surviving corporation in a merger.

Introduction

Macy's East, Inc. is engaged in the business of operating retail department stores in Massachusetts and elsewhere. On July 15, 1986, R.H. Macy & Company, Inc. (then known as Macy Acquiring Corporation) and certain of its subsidiaries acquired the former R.H. Macy & Co., Inc., a New York corporation, in a leveraged buyout. On May 3, 1988, Federated Department Stores, Inc. ("Federated") was acquired by a Canadian corporation, Campeau Corporation, in a hostile takeover.

On January 15, 1990, Federated and certain of its subsidiaries voluntarily filed for relief under Chapter 11 of the Bankruptcy Code. The bankruptcy filing included the operations of Jordan Marsh and A&S, which at the time were subsidiaries of Federated. On February 4, 1992, Federated emerged from Chapter 11 pursuant to a confirmed plan of reorganization. At that time, Federated operated its business through seven retail operating subsidiaries, including Jordan Marsh and A&S. In March, 1992, Jordan Marsh informally merged its back office operations with the back office operations of A&S.

On January 27, 1992, R.H. Macy & Company, Inc. and certain of its subsidiaries voluntarily filed for relief under Chapter 11 of the Bankruptcy Code. The bankruptcy filing included the operations of Macy's Northeast, Inc. and Macy's South, Inc., which at the time were subsidiaries of R.H. Macy & Company, Inc. R.H. Macy & Company, Inc.

continued to conduct its retail business through several operating subsidiaries, the principal subsidiaries being Macy's Northeast, Inc. and Macy's South, Inc. Macy's Northeast, Inc. and Macy's South, Inc. were engaged in the business of operating retail department stores outside Massachusetts.

On September 8, 1994, the Bankruptcy Court approved an agreement of merger between Federated and R.H. Macy & Company, Inc. On December 19, 1994, Federated merged into R.H. Macy & Company, Inc., and the surviving corporation changed its name to Federated.

On December 14, 1994, as part of the reorganization approved by the Bankruptcy Court, Macy's East, Inc. was incorporated as a subsidiary of Federated for the purpose of operating the business of Macy's Northeast, Inc. and Macy's South, Inc. On December 19, 1994, the operations of Macy's Northeast, Inc. and Macy's South, Inc. were merged into Macy's East, Inc. Prior to the merger into Macy's East, Inc., Macy's Northeast, Inc. and Macy's South, Inc. had accumulated substantial net operating loss carryforwards during their 1991 through 1995 fiscal years. Following the merger of Macy's Northeast, Inc. and Macy's South, Inc. into Macy's East, Inc., Macy's East, Inc. continued to operate the same business as Macy's Northeast, Inc. and Macy's South, Inc. Macy's East, Inc. operated under the same tax identification number as Macy's Northeast, Inc.

On August 26, 1995, Jordan Marsh and A&S were merged into Macy's East, Inc. Jordan Marsh, or a predecessor corporation, was qualified to conduct business in Massachusetts and was engaged in the business of operating retail department stores in Massachusetts for more than

100 years. It also operated department stores in other New England states. A&S operated retail department stores in New York State and New Jersey. Prior to the merger of Jordan Marsh and A&S into Macy's East, Inc., Jordan Marsh and A&S had accumulated substantial net operating loss carryforwards during the 1991 through 1995 fiscal years. Following the merger of Jordan Marsh and A&S into Macy's East, Inc., Macy's East, Inc. continued to operate the same business as Jordan Marsh and A&S.

Macy's East, Inc. timely filed a combined Corporation Excise return for the tax year ended February 1, 1997 and paid Massachusetts Corporation Excise in the amount of $1,743,466, of which $1,349,808 was the income portion of the Excise.

On or about May 8, 1998, Macy's East, Inc. filed an amended Massachusetts Corporation Excise Tax return for the tax year ended February 1, 1997. The amended return included net operating loss carryover attributable to the pre-merger activities of Jordan Marsh (i.e., losses incurred during its 1991 through 1995 fiscal years) and requested a refund of $1,349,808.

On or about August 19, 1999, Macy's East, Inc. filed a second amended Massachusetts Corporation Excise Tax return for the tax year ended February 1, 1997. The second amended return also included net operating loss carryover attributable to the pre-merger activities of Macy's Northeast, Inc. and Macy's South, Inc. (i.e., losses incurred in reporting periods prior to December 19, 1994).

On or about April 13, 2000, Macy's East, Inc. filed a third amended Corporation Excise return for the tax year ended February 1, 1997 to include in part, relevant to this report, net operating loss carryover attributable to the pre-merger

activities of A&S (i.e., losses incurred in reporting periods prior to August 26, 1995). The second and third amended returns filed by Macy's East, Inc. do not increase the amount of refund requested in the original amended return.

The Massachusetts net operating loss was enacted in 1973 and was available to new corporations in their first five years of business. In 1989, the Massachusetts net operating loss was made available to all corporations, not just new corporations, subject to certain phase-in limitations. Massachusetts General Laws, chapter 63, sections 30.5(b) and (c) permit carryovers of Massachusetts net operating losses subject to certain restrictions and limitations. Losses may be carried forward for up to five years and may not be carried back. The Net Operating Loss Deductions and Carryover Regulation, 830 CMR 63.30.2(11), provides limitations on the net operating loss carryover not found in the Massachusetts General Laws where there is a merger of two or more corporations.

In order to determine the appropriate amount of net operating loss carryover available to Macy's East, Inc. in Massachusetts for the tax year ended February 1, 1997, I developed an analysis of the Massachusetts apportionable income and/or loss generated by Macy's East, Inc., A&S, Macy's Northeast, Inc. and Macy's South, Inc. for the tax years ended August 1, 1992 through January 28, 1995. I initially met with representatives of the company at the corporate headquarters in Cincinnati, Ohio in order to understand the nature of the company's activities in Massachusetts. I also reviewed various information including the federal and Massachusetts corporate income tax returns, accounting workpapers, annual reports and other relevant financial and internal documents. In

addition, I conducted follow-up conversations with company representatives and further reviewed relevant documents as part of my analysis.

For those entities with nexus in Massachusetts, the apportionable income and/or loss generated by Macy's East, Inc. (for the tax years ended February 3, 1996 through February 1, 1997) and Jordan Marsh (for the tax years ended January 30, 1993 through August 26, 1995) was determined by reference to the federal taxable income and/or loss reported by each entity (as reflected on Form 1120, U.S. Corporation Income Tax Return, Line 28), and Schedule E of the Massachusetts combined return. With respect to those entities not required to file a return in Massachusetts, the apportionable income and/or loss of each entity was determined by taking the amount of federal taxable income and/or loss reported by each entity (as reflected on Form 1120, U.S. Corporation Income Tax Return, Line 28) and making certain adjustments (e.g., disallowed contribution deductions, state and local taxes and federal audit adjustments made by the Internal Revenue Service to the reported taxable income of Macy's South, Inc. and Macy's Northeast, Inc. for the tax period August 1, 1992 through July 31, 1993). I then applied the unused net operating losses of Jordan Marsh, Macy's Northeast, Inc. and Macy's South, Inc. to the income generated by Macy's East, Inc. for the tax year ended February 1, 1997. The results of my analysis setting forth the appropriate amount of net operating loss carryover available to Macy's East, Inc. in Massachusetts for the tax year ended February 1, 1997 are contained in Exhibit "A".

The Massachusetts net operating loss provisions generally provide that a net operating loss carryover may be deducted only from the income of that combined group

member which generated the carryover. This limitation was embodied in the holding in *Farrell Enterprises, Inc. v. Commissioner of Revenue*, 46 Mass. 564; 707 N.E.2d 1088 (1999). *Farrell Enterprises* does not address how the surviving corporation in a merger computes a net operating loss carryover attributable to pre-merger losses. However, assuming the aforesaid limitation is imposed so that a net operating loss carryover is available only against income from the same operations that generated the loss, the amount of net operating loss carryover available to Macy's East, Inc. in Massachusetts for the tax year ended February 1, 1997 is set forth in my analysis contained in Exhibit "B". As reflected in Exhibit "B", even if the *Farrell Enterprises* limitation is imposed, the amount of the refund requested by Macy's East, Inc. would not be decreased since the Massachusetts apportionable income of each entity would still be reduced to zero.

In order to determine the amount of net operating loss carryover available to Macy's East, Inc. in Exhibit "B" for the tax year ended February 1, 1997, I developed an analysis of the actual income and/or loss subject to apportionment in Massachusetts for (1) Macy's East, Inc. for the tax years ending January 28, 1995 through February 1, 1997, (2) Jordan Marsh for the tax years ending January 30, 1993 through February 1, 1997, (3) A&S for the tax years ending January 29, 1994 through February 1, 1997, and (4) Macy's Northeast, Inc. and Macy's South, Inc. for the tax years ending August 1, 1992 through February 1, 1997.

I also developed a separate accounting analysis of the income generated by Macy's East, Inc. for the tax year ended February 1, 1997, as reflected in Exhibit "C". This analysis reflects the amount of income and/or loss generated

by each of the stores of Macy's East, Inc. for the tax year ended February 1, 1997. As reflected in Exhibit "C", the income generated by Macy's East, Inc. during the year ($201,209,267) was derived from stores operating outside of Massachusetts which were formerly owned by Macy's Northeast, Inc. and Macy's South, Inc. Macy's East, Inc. operated eleven former Jordan Marsh stores in Massachusetts for the tax year ended February 1, 1997. Macy's East, Inc. had no other operations in Massachusetts during that year. These stores generated an aggregate loss in Massachusetts of $28,935,890 for the tax year ended February 1, 1997 (refer to Exhibit "C-6").

As evidenced by the above, I believe that the amount of the refund requested by Macy's East, Inc. for the tax year ended February 1, 1997 is correct since the Massachusetts apportionable income of each of the members of the combined group would be reduced to zero after the application of net operating loss carryovers. For the tax year ended February 1, 1997, the amount of net operating loss carryovers available on a separate company basis to each of the members of the combined group is $860,267 for Macy's East, Inc., $309,154,296 for Macy's Northeast, Inc., $115,308,047 for Macy's South, Inc., $217,330,350 for Jordan Marsh, and $79,449,853 for A&S.

Exhibit A

Macy's East, Inc.
Summary of Massachusetts Net Operating Loss

Company	Net Operating Loss Utilized for the Year Ended 2/1/97	
Macy's East, Inc.	(201,209,267)	(1)

Note:

(1) This amount represents the net operating loss that should be applied for the tax year ended February 1, 1997, as reflected on Exhibit A-1.

Exhibit A-1

Macy's East, Inc.
Schedule of Massachusetts Net Operating Loss ("NOL")
Tax Years Ending January 28, 1995 Through February 1, 1997

	1/28/95		2/3/96		2/1/97	
Massachusetts Net Income (Loss)	(99,680,544)	(1)	151,975,771	(2)	201,209,267	(3)
1992 Macy's South, Inc.'s Loss Carryforward to 1996			(58,847,502)	(4)		
1992 Macy's Northeast Inc.'s Loss Carryforward to 1996			(93,128,269)	(5)		
Sub-Total	(99,680,544)		-		201,209,267	
1993 Jordan Marsh Stores Corp.'s Loss Carryforward to 1997					(37,767,036)	(6)
1993 Macy's South, Inc.'s Loss Carryforward to 1997					(56,250,482)	(4)
1993 Macy's Northeast, Inc.'s Loss Carryforward to 1997					(107,191,749)	(5)
Total	(99,680,544)		-		-	

Notes:

(1) Macy's East, Inc. was not taxable in Massachusetts during the year (Massachusetts Corporate Income Regulation Section 830 CMR 63.30.2.(g) allows a foreign corporation not subject to tax to claim a net operating loss deduction). Thus, this amount represents Macy's East, Inc.'s federal taxable income and/or loss for the year (line 28) subject to certain adjustments (e.g., contributions deducted on the return (line 19) during a loss year, and the amount deducted on the return for state and local income/franchise taxes).

(2) This amount represents the sum of (1) Macy's East, Inc.'s income subject to apportionment in Massachusetts for the year of $153,656,152 (as reflected on Schedule E of the Massachusetts return); and (2) adjustments for federal audit changes of $1,680,381.

(3) This amount represents the sum of (1) Macy's East, Inc.'s income subject to apportionment in Massachusetts for the year of $195,024,436 (as reflected on Schedule E of the Massachusetts return); and (2) adjustments for federal audit changes of $6,184,831.

(4) Refer to Exhibit A-3.

(5) Refer to Exhibit A-2.

Exhibit A-2

Macy's Northeast, Inc.
Schedule of Massachusetts Net Operating Loss ("NOL")
Tax Years Ending August 1, 1992 Through December 19, 1994

	8/1/92	7/31/93	7/30/94	12/19/94
Massachusetts Net Income (Loss)	(343,476,099)*	(162,604,370)*	(74,613,173)*	77,901,117
1992 Carryforward to 1994	77,901,117			(77,901,117)
1992 Carryforward to Macy's East, Inc.'s 1996 Year	93,128,269			
1993 Carryforward to Macy's East, Inc.'s 1997 Year		107,191,749		
Total	(172,446,713)	(55,412,621)	(74,613,173)	-
NOL Expired**	172,446,713	55,412,621	-	-
NOL Available	-	-	(74,613,173)	-

Notes:

* Macy's Northeast, Inc. was not taxable in Massachusetts during the year (Massachusetts Corporate Income Regulation Section 830 CMR 63.30.2.(g) allows a foreign corporation not subject to tax to claim a net operating loss deduction). Thus, this amount represents Macy's Northeast, Inc.'s federal taxable income and/or loss for the year (line 28) subject to certain adjustments (e.g., contributions deducted on the return (line 19) during a loss year, adjustments for federal audit changes, and the amount deducted on the federal return for state and local income/franchise taxes).

** NOL expired due to five year carryover limitation.

Exhibit A-3

Macy's South, Inc.
Schedule of Massachusetts Net Operating Loss ("NOL")
Tax Years Ending August 1, 1992 Through December 19, 1994

	8/1/92	7/31/93	7/30/94	12/19/94
Massachusetts Net Income (Loss)	(95,811,571)*	(56,250,482)*	(31,313,774)*	36,964,069*
1992 Carryforward to 1994	36,964,069			(36,964,069)
1992 Carryforward to Macy's East, Inc.'s 1996 Year	58,847,502			
1993 Carryforward to Macy's East, Inc.'s 1997 Year		56,250,482		
NOL Available	-	-	(31,313,774)	-

Note:

* Macy's South, Inc. was not taxable in Massachusetts during the year (Massachusetts Corporate Income Regulation Section 830 CMR 63.30.2.(g) allows a foreign corporation not subject to tax to claim a net operating loss deduction). Thus, this amount represents Macy's South, Inc.'s federal taxable income and/or loss for the year (line 28) subject to certain adjustments (e.g., contributions deducted on the return (line 19) during a loss year, adjustments for federal audit changes, and the amount deducted on the federal return for state and local income/franchise taxes).

Exhibit A-4

Jordan Marsh Stores Corporation
Schedule of Massachusetts Net Operating Loss ("NOL")
Tax Years Ending January 30, 1993 Through August 26, 1995

	1/30/93	1/29/94	1/28/95	8/26/95 **
Massachusetts Net Income (Loss)	(37,767,036)*	(56,682,693)*	(64,881,201)*	(48,352,443)*
1993 Carryforward to Macy's East, Inc.'s 1997 Year	37,767,036			
NOL Available	-	(56,682,693)	(64,881,201)	(48,352,443)

Notes:

* This figure represents the amount of income and/or loss subject to apportionment in Massachusetts for the year (as reflected on Schedule E of the Massachusetts combined return filed by the group) reduced by the amount of losses utilized and/or offset against the income of other profitable entities of the Massachusetts combined group.

** The amount of income and/or loss generated by Jordan Marsh Stores Corporation in Massachusetts for this period was reflected as part of Macy's East, Inc.'s Massachusetts combined taxable income schedule (Schedule E) for the tax period ending February 3, 1996.

Exhibit A-5

Abraham & Straus, Inc.
Schedule of Massachusetts Net Operating Loss ("NOL")
Tax Years Ending January 29, 1994 Through August 26, 1995

	1/29/94	1/28/95	8/26/95
Massachusetts Net Income (Loss)	(22,682,627)*	(15,620,192)*	(45,344,585)*
NOL Expired	-	-	-
NOL Available	(22,682,627)	(15,620,192)	(45,344,585)

Note:

* Abraham & Straus, Inc. was not taxable in Massachusetts during the year (Massachusetts Corporate Income Regulation Section 830 CMR 63.30.2.(g) allows a foreign corporation not subject to tax to claim a net operating loss deduction). Thus, this amount represents Abraham & Straus, Inc.'s federal taxable income and/or loss for the year (line 28) subject to certain adjustments (e.g., contributions deducted on the return (line 19) during a loss year, and the amount deducted on the federal return for state and local income/franchise taxes).

Exhibit B

Macy's East, Inc.
Summary of Massachusetts Net Operating Loss
Based On A Separate Company Analysis

Company	Net Operating Loss Utilized for the Year Ended 2/1/97	
Macy's East, Inc.	-	(1)
Macy's Northeast, Inc.	(193,528,538)	(2)
Macy's South, Inc.	(48,635,433)	(3)
Jordan Marsh Stores Corp.	-	(4)
Abraham & Straus, Inc.	-	(5)
Total	(242,163,971)	

Notes:

(1) Refer to Exhibit B-1
(2) Refer to Exhibit B-2
(3) Refer to Exhibit B-3
(4) Refer to Exhibit B-4
(5) Refer to Exhibit B-5

Exhibit B-1

Macy's East, Inc.
Schedule of Massachusetts
Net Operating Loss ("NOL")
Tax Years Ending February 3, 1996
through February 1, 1997

	2/3/96	2/1/97
Massachusetts Net Income (Loss)	(860,267)*	(3,886,428)*
NOL Expired	-	-
NOL Available	(860,267)	(3,886,428)

Note:

* This amount represents Macy's East, Inc.'s separate federal taxable income and/or loss generated by each store owned by the company subject to certain adjustments (e.g., the amount deducted on the federal return for state and local income/franchise taxes attributable to the company's owned stores). These losses were generated by businesses commenced by Macy's East, Inc., which were never part of the predecessor corporations.

Exhibit B-2

Macy's Northeast, Inc.
Schedule of Massachusetts Net Operating Loss ("NOL")
Tax Years Ending August 1, 1992 Through February 1, 1997

	8/1/92	7/31/93	7/30/94	12/19/94	1/28/95	2/3/96	2/1/97
Massachusetts Net Income (Loss)	(343,476,099)*	(162,604,370)*	(74,613,173)*	77,901,117*	(71,936,753)**	122,987,393**	193,528,538**
1992 Carryforward to 1994	77,901,117			(77,901,117)			
1992 Carryforward to 1996	122,987,393					(122,987,393)	
1993 Carryforward to 1997		162,604,370					(162,604,370)
1994 Carryforward to 1997			30,924,168				(30,924,168)
Sub-Total	(142,587,589)	-	(43,689,005)	-	(71,936,753)	-	-
NOL Expired***	142,587,589	-	-	-	-	-	-
NOL Available	-	-	(43,689,005)	-	(71,936,753)	-	-

Notes:

* This amount represents Macy's Northeast, Inc.'s federal taxable income for the year (line 28) subject to certain adjustments (e.g., contributions deducted on the return (line 19) during a loss year, adjustments for federal audit changes, and the amount deducted on the federal return for state and local income/franchise taxes).

** This amount represents Macy's Northeast, Inc.'s separate federal taxable income and/or loss generated by each store owned by the company subject to certain adjustments (e.g., the amount deducted on the federal return for state and local income/franchise taxes attributable to the company's owned stores).

*** NOL expired due to five year carryover limitation.

Exhibit B-3

Macy's South, Inc.
Schedule of Massachusetts Net Operating Loss ("NOL")
Tax Years Ending August 1, 1992 Through February 1, 1997

	8/1/92	7/31/93	7/30/94	12/19/94	1/28/95	2/3/96	2/1/97
Massachusetts Net Income (Loss)	(95,811,571)*	(56,250,482)*	(31,313,774)*	36,964,069*	(27,743,791)**	35,298,072**	48,635,433**
1992 Carryforward to 1994	36,964,069			(36,964,069)			
1992 Carryforward to 1996	35,298,072					(35,298,072)	
1993 Carryforward to 1997		48,635,433					(48,635,433)
Sub-Total	(23,549,430)	(7,615,049)	(31,313,774)	-	(27,743,791)	-	-
NOL Expired***	23,549,430	7,615,049	-	-	-	-	-
NOL Available	-	-	(31,313,774)	-	(27,743,791)	-	-

Notes:

* This amount represents Macy's South, Inc.'s federal taxable income and/or loss for the year (line 28) subject to certain adjustments (e.g., contributions deducted on the return (line 19) during a loss year, adjustments for federal audit changes, and the amount deducted on the federal return for state and local income/franchise taxes).

** This amount represents the separate federal taxable income and/or loss generated by each store formerly owned by Macy's South, Inc. subject to certain adjustments (e.g., the amount deducted on the federal return for state and local income/franchise taxes attributable to such stores).

*** NOL expired due to five year carryover limitation.

Exhibit B-4

Jordan Marsh Stores Corp.
Schedule of Massachusetts Net Operating Loss ("NOL")
Tax Years Ending January 30, 1993 Through February 1, 1997

	1/30/93	1/29/94	1/28/95	2/1/95 to 8/31/95	9/1/95 to 2/3/96	2/1/97
Massachusetts Net Income (Loss)	(37,767,036)*	(56,682,693)*	(64,881,201)*	(48,352,443)*	(9,646,977)**	(31,049,441)**
1992 Carryforward to 1996						
1993 Carryforward to 1997						
Sub-Total	(37,767,036)	(56,682,693)	(64,881,201)	(48,352,443)	(9,646,977)	(31,049,441)
NOL Expired***	37,767,036		-	-	-	-
NOL Available	-	(56,682,693)	(64,881,201)	(48,352,443)	(9,646,977)	(31,049,441)

Notes:

* This figure represents the amount of income and/or loss subject to apportionment in Massachusetts for the year (as reflected on Schedule E of the Massachusetts return) reduced by the amount of losses utilized and/or offset against the income of other profitable entities of the Massachusetts combined group.

** This amount represents the separate federal taxable income and/or loss generated by each store formerly owned by Jordan Marsh Stores Cop. subject to certain adjustments (e.g., the amount deducted on the federal return for state and local income/franchise taxes attributable to such stores).

*** NOL expired due to five year carryover limitation.

Exhibit B-5

Abraham & Straus, Inc.
Schedule of Massachusetts Net Operating Loss ("NOL")
Tax Years Ending January 29, 1994 Through February 1, 1997

	1/29/94	1/28/95	8/31/95	2/3/96	2/1/97
Massachusetts Net Income (Loss)	(22,682,627)*	(15,620,192)*	(45,344,585)*	4,197,551**	(6,018,833)**
1994 Carryforward to 1996	4,197,551			(4,197,551)	-
NOL Available	(18,485,076)	(15,620,192)	(45,344,585)	-	(6,018,833)

Notes:

* This amount represents Abraham & Straus, Inc.'s federal taxable income for the year (line 28) subject to certain adjustments (e.g., contributions deducted on the return (line 19), during a loss year, adjustments for federal audit changes, and the amount deducted on the federal return for state and local income/franchise taxes).

** This amount represents the separate federal taxable income and/or loss generated by each store formerly owned by Abraham & Straus, Inc. subject to certain adjustments (e.g., the amount deducted on the federal return for state and local income/franchise taxes attributable to such stores).

Exhibit C

Macy's East, Inc.
Analysis of Income (Loss)
Tax Year Ending February 1, 1997

Stores Formerly Part of:	Income (Loss)	
Macy's Northeast, Inc.	193,528,537	(1)
Macy's South, Inc.	48,635,434	(2)
Jordan Marsh Stores Corp.	(31,049,442)	(3)
Abraham & Straus, Inc.	(6,018,835)	(4)
Macy's East, Inc.	(3,886,427)	(5)
Total	201,209,267	

Notes:

(1) Refer to Exhibit C-1
(2) Refer to Exhibit C-2
(3) Refer to Exhibit C-3
(4) Refer to Exhibit C-4
(5) Refer to Exhibit C-5

Exhibit C-1

Macy's East, Inc.
Stores Formerly Part of Macy's Northeast, Inc.
Summary of Income (Loss)
Tax Year Ending February 1, 1997

Store No.	Location		Income (Loss)
3	Herald Square	New York	39,437,353
6	Brooklyn	New York	9,434,249
7	Staten Island	New York	8,260,077
8	Menlo Park	New Jersey	9,521,846
13	Smith Haven	New York	10,225,857
16	Livingston	New Jersey	1,710,490
20	Stamford	Connecticut	(2,448,350)
22	Parkchester	New York	1,264,917
28	Danbury	Connecticut	5,357,594
30	White Plains	New York	2,469,106
32	Massapequa	New York	2,426,262
52	Monmouth	New Jersey	3,662,718
53	Roosevelt	New York	10,266,263
54	Huntington	New York	2,516,766
56	Bayshore	New York	1,607,233
59	Cherry Hill	New Jersey	1,314,889
64	Oxford Valley	Pennsylvania	686
65	Quakerbridge	New Jersey	4,582,549
66	Deptford	New Jersey	2,590,097
70	Lehigh Valley	Pennsylvania	5,489,634
71	Ocean County	New Jersey	3,185,534
72	Rockaway	New Jersey	6,675,248
73	Montgomeryville	Pennsylvania	3,989,131
74	Christiana	Delaware	4,053,373
75	Garden State	New Jersey	2,086,892
76	Willowbrook	New Jersey	8,450,598
78	Tysons	Virginia	3,339,538

79	Nanuet	New York	3,159,401
80	Hamilton	New Jersey	5,951,195
81	Bridgewater	New Jersey	9,331,435
83	Colonie	New York	3,556,836
84	Springfield, VA	Virginia	2,730,245
88	East Brunswick	New Jersey	1,162,760
89	Springfield, PA	Pennsylvania	3,231,352
90	King Prussia	Pennsylvania	(52,415)
91	White Station	Maryland	1,325,639
92	Marley Station	Maryland	798,317
93	Owings Mill	Maryland	1,540,564
95	Pentagon	Virginia	8,880,621
152	EatonTown	New Jersey	442,037
			193,528,537

Exhibit C-2

Macy's East, Inc.
Stores Formerly Part of Macy's South, Inc.
Summary of Income (Loss)
Tax Year Ending February 1, 1997

Store No.	Location		Income (Loss)
24	Aventura	Florida	9,270,641
25	Riverchase	Alabama	1,941,268
26	Augusta	Georgia	1,414,113
27	Macon	Georgia	2,674,348
29	Plantation	Florida	6,109,140
33	Northlake	Georgia	1,267,890
42	Lenox	Georgia	3,700,042
57	Shannon	Georgia	(770,610)
60	Town Cente at Cobb	Georgia	3,707,930
68	Perimeter	Georgia	261,228
69	Gwinnett	Georgia	1,661,191
82	Esplanade	Louisiana	4,328,454
85	New Orleans	Louisiana	2,336,510
86	Cumberland	Georgia	510,182
87	Boynton	Florida	3,191,587
94	Athens	Georgia	1,633,296
96	Southlake	Georgia	(448,704)
97	Peachtree	Georgia	1,010,417
98	Palm Beach	Florida	4,836,511
			48,635,434

Exhibit C-3

Macy's East, Inc.
Stores Formerly Part of Jordan Marsh Stores Corp.
Summary of Income (Loss)
Tax Year Ending February 1, 1997

Store No.	Location		Income (Loss)
31	Boston	Massachusetts	(12,650,379)
34	Peabody	Massachusetts	(4,674,320)
35	Bedford	New Hampshire	1,861,210
36	Braintree	Massachusetts	(3,506,392)
37	Burlington	Massachusetts	(1,701,885)
38	Portland	Maine	845,392
39	Warwick	Rhode Island	1,741,798
40	Natick	Massachusetts	(4,249,134)
41	Salem	New Hampshire	(1,819,763)
43	Brockton	Massachusetts	(199,638)
44	Cape Cod	Massachusetts	(447,629)
45	Somerville	Massachusetts	(1,432,680)
46	Newington	New Hampshire	293,108
47	Hanover	Massachusetts	(537,812)
48	Waterford	Connecticut	181,738
49	Albany	New York	220,339
50	Nashua	New Hampshire	(1,247,811)
58	Swansea	Massachusetts	(52,687)
140	Framingham	Massachusetts	516,663
WHS	Quincey	Massachusetts	(4,189,560)
			(31,049,442)

Exhibit C-4

Macy's East, Inc.
Stores Formerly Part of Abraham & Straus, Inc.
Summary of Income (Loss)
Tax Year Ending February 1, 1997

Store No.	Location		Income (Loss)
1	Rego Park	New York	2,539,316
2	Brooklyn	New York	(4,943,994)
4	Huntington	New York	(80,161)
5	Manhasset	New York	(140,338)
9	Smithhaven	New York	3,000
10	Paramus	New Jersey	2,636,172
14	White Plains	New York	(484,894)
15	Short Hills	New Jersey	789,434
17	New York	New York	(167,131)
18	Roosevelt	New York	(5,557,265)
19	Valley Stream	New York	2,846,078
21	Nanuet	New York	(300,064)
51	Trumbull	Connecticut	(2,111,760)
55	Yorktown	New York	1,509,292
106	Woodbridge	New Jersey	(1,054)
118	Carle Place	New York	(2,572,493)
WHS	Secaucus	New Jersey	17,027
			(6,018,835)

Exhibit C-5

Macy's East, Inc.
Summary of Income (Loss)
Tax Year Ending February 1, 1997

Store No.	Location*		Income (Loss)
101	Miami	Florida	(1,306,984)
102	Huntington	New York	(1,531,516)
176	Wayne	New Jersey	654,880
181	Springfield	New Jersey	409,029
188	No. Brunswick	New Jersey	(84,625)
	1-800 Macy Bed	New York	(2,027,211)
			(3,886,427)

Note:

* These locations were opened by Macy's East, Inc. and, therefore, were never part of Jordan Marsh Stores Corp., Macy's Northeast, Inc., Macy's South, Inc. or Abraham & Straus, Inc.

Exhibit C-6

Macy's East, Inc.
Stores Formerly Part of Jordan Marsh Stores Corp.
Located in Massachusetts
Tax Year Ending February 1, 1997

	Boston Store #31	Peabody Store #34	Braintree Store #36	Burlington Store #37	Natick Store #40	Brockton Store #43	Cape Cod Store #44	Somerville Store #45	Hanover Store #47	Swansea Store #58	Framingh Store #1
Sales	59,815,982	40,005,113	46,442,322	45,218,922	37,871,158	13,958,247	20,684,813	14,112,368	13,169,963	17,901,972	7,483,
Cost of Sales	40,338,372	25,616,281	29,588,935	28,713,621	24,653,733	9,126,587	13,430,316	9,394,627	8,591,385	11,257,601	4,501,
Gross Profit	19,477,610	14,388,832	16,853,387	16,505,301	13,217,425	4,831,660	7,254,497	4,717,741	4,578,578	6,644,371	2,981,
Interest Income	127	85	98	96	80	30	44	30	28	38	
Total Income	19,477,737	14,388,917	16,853,485	16,505,397	13,217,505	4,831,690	7,254,541	4,717,771	4,578,606	6,644,409	2,981,
G&A Expenses	24,150,000	15,684,000	16,056,000	14,995,000	15,168,000	4,359,000	6,631,000	5,582,000	4,498,000	6,235,000	2,036,
Depreciation Expense	2,284,893	2,624,844	2,489,267	1,834,934	451,198	352,468	609,618	458,603	336,051	715,738	281,
Capital Lease Expense	-	-	-	-	409,472	-	-	-	-	-	-
Transfer Expense	464,915	310,937	360,969	351,461	294,351	108,489	160,771	109,687	102,363	139,142	58,
Other Expenses	5,124,445	(1,272,896)	1,104,698	1,455,180	846,542	204,635	88,460	37,030	138,500	(66,355)	(1
Total Expenses	32,024,253	17,346,885	20,010,934	18,636,575	17,169,563	5,024,592	7,489,849	6,187,320	5,074,914	7,023,525	2,374
Book Income	(12,546,516)	(2,957,968)	(3,157,449)	(2,131,178)	(3,952,058)	(192,902)	(235,308)	(1,469,549)	(496,308)	(379,116)	607
Federal Adjustments	(337,896)	(1,872,874)	(530,651)	252,371	(445,249)	(61,348)	(293,251)	(18,347)	(93,032)	256,387	(120
Federal Audit Changes	81,470	54,487	63,255	61,588	51,581	19,011	28,173	19,221	17,938	24,383	10
Federal Taxable Income	(12,802,942)	(4,776,355)	(3,624,845)	(1,817,219)	(4,345,726)	(235,239)	(500,386)	(1,468,675)	(571,402)	(98,346)	497
State Modifications	152,564	102,035	118,454	115,333	96,592	35,601	52,758	35,994	33,591	45,660	19
State Taxable Income	12,650,378	4,674,320	(3,506,391)	(1,701,886)	(4,249,134)	(199,638)	(447,628)	(1,432,681)	(537,811)	(52,686)	516